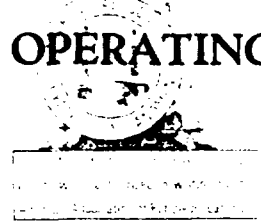


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A.A.P.L. FORM 610 - 1977

MODEL FORM OPERATING AGREEMENT



OPERATING AGREEMENT

DATED

September 14, 1983 ,

OPERATOR Ammex Petroleum, Inc.

CONTRACT AREA S 1/2 NE 1/4 and S 1/2 SE 1/4 of Section 28

Township 23 South, Range 28 East, N.M.P.M.

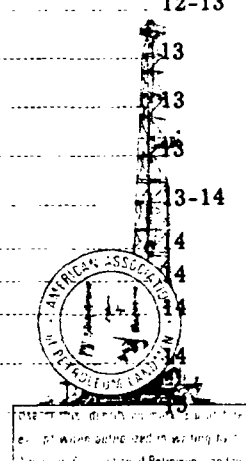
COUNTY OR PARISH OF Eddy STATE OF New Mexico

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OPERATING AGREEMENT

THIS AGREEMENT, entered into by and between Amnax Petroleum, Inc., hereinafter designated and referred to as "Operator", and the signatory party or parties other than Operator, sometimes hereinafter referred to individually herein as "Non-Operator", and collectively as "Non-Operators",

WITNESSETH:

WHEREAS, the parties to this agreement are owners of oil and gas leases and/or oil and gas interests in the land identified in Exhibit "A", and the parties hereto have reached an agreement to explore and develop these leases and/or oil and gas interests for the production of oil and gas to the extent and as hereinafter provided:

NOW, THEREFORE, it is agreed as follows:

ARTICLE I. DEFINITIONS

As used in this agreement, the following words and terms shall have the meanings here ascribed to them:

- A. The term "oil and gas" shall mean oil, gas, casinghead gas, gas condensate, and all other liquid or gaseous hydrocarbons and other marketable substances produced therewith, unless an intent to limit the inclusiveness of this term is specifically stated.
B. The terms "oil and gas lease", "lease" and "leasehold" shall mean the oil and gas leases covering tracts of land lying within the Contract Area which are owned by the parties to this agreement.
C. The term "oil and gas interests" shall mean unleased fee and mineral interests in tracts of land lying within the Contract Area which are owned by parties to this agreement.
D. The term "Contract Area" shall mean all of the lands, oil and gas leasehold interests and oil and gas interests intended to be developed and operated for oil and gas purposes under this agreement. Such lands, oil and gas leasehold interests and oil and gas interests are described in Exhibit "A".
E. The term "drilling unit" shall mean the area fixed for the drilling of one well by order or rule of any state or federal body having authority. If a drilling unit is not fixed by any such rule or order, a drilling unit shall be the drilling unit as established by the pattern of drilling in the Contract Area or as fixed by express agreement of the Drilling Parties.
F. The term "drillsite" shall mean the oil and gas lease or interest on which a proposed well is to be located.
G. The terms "Drilling Party" and "Consenting Party" shall mean a party who agrees to join in and pay its share of the cost of any operation conducted under the provisions of this agreement.
H. The terms "Non-Drilling Party" and "Non-Consenting Party" shall mean a party who elects not to participate in a proposed operation.

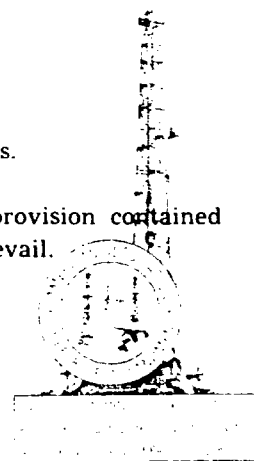
Unless the context otherwise clearly indicates, words used in the singular include the plural, the plural includes the singular, and the neuter gender includes the masculine and the feminine.

ARTICLE II. EXHIBITS

The following exhibits, as indicated below and attached hereto, are incorporated in and made a part hereof:

- [X] A. Exhibit "A", shall include the following information:
(1) Identification of lands subject to agreement,
(2) Restrictions, if any, as to depths or formations,
(3) Percentages or fractional interests of parties to this agreement,
(4) Oil and gas leases and/or oil and gas interests subject to this agreement,
(5) Addresses of parties for notice purposes.
[X] B. Exhibit "B", Form of Lease.
[X] C. Exhibit "C", Accounting Procedure.
[X] D. Exhibit "D", Insurance.
[ ] E. Exhibit "E", Gas Balancing Agreement.
[X] F. Exhibit "F", Non-Discrimination and Certification of Non-Segregated Facilities.
[X] G. Exhibit "G", Geological Information and Test Data

If any provision of any exhibit, except Exhibit "E", is inconsistent with any provision contained in the body of this agreement, the provisions in the body of this agreement shall prevail.



ARTICLE III.  
INTERESTS OF PARTIES

A. Oil and Gas Interests:

If any party owns an unleased oil and gas interest in the Contract Area, that interest shall be treated for the purpose of this agreement and during the term hereof as if it were a leased interest under the form of oil and gas lease attached as Exhibit "B". As to such interest, the owner shall receive royalty on production as prescribed in the form of oil and gas lease attached hereto as Exhibit "B". Such party shall, however, be subject to all of the provisions of this agreement relating to lessees, to the extent that it owns the lessee interest.

B. Interest of Parties in Costs and Production:

Exhibit "A" lists all of the parties and their respective percentage or fractional interests under this agreement. Unless changed by other provisions, all costs and liabilities incurred in operations under this agreement shall be borne and paid, and all equipment and material acquired in operations on the Contract Area shall be owned by the parties as their interests are shown in Exhibit "A". All production of oil and gas from the Contract Area, subject to the payment of lessor's royalties ~~which will be borne by the Joint Account~~, shall also be owned by the parties in the same manner during the term hereof; provided, however, this shall not be deemed an assignment or cross-assignment of interests covered hereby.

ARTICLE IV.  
TITLES

A. Title Examination:

Title examination shall be made on the drillsite of any proposed well prior to commencement of drilling operations or, if the Drilling Parties so request, title examination shall be made on the leases and or oil and gas interests included, or planned to be included, in the drilling unit around such well. The opinion will include the ownership of the working interest, minerals, royalty, overriding royalty and production payments under the applicable leases. At the time a well is proposed, each party contributing leases and or oil and gas interests to the drillsite, or to be included in such drilling unit, shall furnish to Operator all abstracts (including Federal Lease Status Reports), title opinions, title papers and curative material in its possession free of charge. All such information not in the possession of or made available to Operator by the parties, but necessary for the examination of title, shall be obtained by Operator. Operator shall cause title to be examined by attorneys on its staff or by outside attorneys. Copies of all title opinions shall be furnished to each party hereto. The cost incurred by Operator in this title program shall be borne as follows:

Option No. 1: Costs incurred by Operator in procuring abstracts and title examination (including preliminary, supplemental, shut-in gas royalty opinions and division order title opinions) shall be a part of the administrative overhead as provided in Exhibit "C," and shall not be a direct charge, whether performed by Operator's staff attorneys or by outside attorneys.

Option No. 2: Costs incurred by Operator in procuring abstracts and fees paid outside attorneys for title examination (including preliminary, supplemental, shut-in gas royalty opinions and division order title opinions) shall be borne by the Drilling Parties in the proportion that the interest of each Drilling Party bears to the total interest of all Drilling Parties as such interests appear in Exhibit "A". Operator shall make no charge for services rendered by its staff attorneys or other personnel in the performance of the above functions.

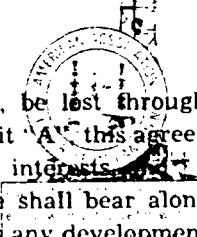
Each party shall be responsible for securing curative matter and pooling amendments or agreements required in connection with leases or oil and gas interests contributed by such party. The Operator shall be responsible for the preparation and recording of Pooling Designations or Declarations as well as the conduct of hearings before Governmental Agencies for the securing of spacing or pooling orders. This shall not prevent any party from appearing on its own behalf at any such hearing.

No well shall be drilled on the Contract Area until after (1) the title to the drillsite or drilling unit has been examined as above provided, and (2) the title has been approved by the examining attorney or title has been accepted by all of the parties who are to participate in the drilling of the well.

B. Loss of Title:

1. Failure of Title: Should any oil and gas interest or lease, or interest therein, be lost through failure of title, which loss results in a reduction of interest from that shown on Exhibit "A" this agreement, nevertheless, shall continue in force as to all remaining oil and gas leases and interests.

(a) The party whose oil and gas lease or interest is affected by the title failure shall bear alone the entire loss and it shall not be entitled to recover from Operator or the other parties any development



1 or operating costs which it may have theretofore paid, but there shall be no monetary liability on its  
2 part to the other parties hereto for drilling, development, operating or other similar costs by reason of  
3 such title failure; and

4 (b) There shall be no retroactive adjustment of expenses incurred or revenues received from the  
5 operation of the interest which has been lost, but the interests of the parties shall be revised on an acre-  
6 age basis, as of the time it is determined finally that title failure has occurred, so that the interest of  
7 the party whose lease or interest is affected by the title failure will thereafter be reduced in the Contract  
8 Area by the amount of the interest lost; and

9 (c) If the proportionate interest of the other parties hereto in any producing well theretofore drilled  
10 on the Contract Area is increased by reason of the title failure, the party whose title has failed shall  
11 receive the proceeds attributable to the increase in such interests (less costs and burdens attributable  
12 thereto) until it has been reimbursed for unrecovered costs paid by it in connection with such well;  
13 and

14 (d) Should any person not a party to this agreement, who is determined to be the owner of any in-  
15 terest in the title which has failed, pay in any manner any part of the cost of operation, development,  
16 or equipment, such amount shall be paid to the party or parties who bore the costs which are so refund-  
17 ed; and

18 (e) Any liability to account to a third party for prior production of oil and gas which arises by  
19 reason of title failure shall be borne by the party or parties <sup>whose title failed</sup> in the same proportions in which they shared  
20 in such prior production; and

21 (f) No charge shall be made to the joint account for legal expenses, fees or salaries, in connection  
22 with the defense of the interest claimed by any party hereto, it being the intention of the parties  
23 hereto that each shall defend title to its interest and bear all expenses in connection therewith.  
24

25 2. Loss by Non-Payment or Erroneous Payment of Amount Due: If, through mistake or oversight,  
26 any rental, shut-in well payment, minimum royalty or royalty payment, is not paid or is erroneously  
27 paid, and as a result a lease or interest therein terminates, there shall be no monetary liability against  
28 the party who failed to make such payment. Unless the party who failed to make the required payment  
29 secures a new lease covering the same interest within ninety (90) days from the discovery of the fail-  
30 ure to make proper payment, which acquisition will not be subject to Article VIII.B., the interests of  
31 the parties shall be revised on an acreage basis, effective as of the date of termination of the lease in-  
32 volved, and the party who failed to make proper payment will no longer be credited with an interest in  
33 the Contract Area on account of ownership of the lease or interest which has terminated. In the event  
34 the party who failed to make the required payment shall not have been fully reimbursed, at the time of  
35 the loss, from the proceeds of the sale of oil and gas attributable to the lost interest, calculated on an  
36 acreage basis, for the development and operating costs theretofore paid on account of such interest, it  
37 shall be reimbursed for unrecovered actual costs theretofore paid by it (but not for its share of the  
38 cost of any dry hole previously drilled or wells previously abandoned) from so much of the following  
39 as is necessary to effect reimbursement:

40 (a) Proceeds of oil and gas, less operating expenses, theretofore accrued to the credit of the lost  
41 interest, on an acreage basis, up to the amount of unrecovered costs;

42 (b) Proceeds, less operating expenses, thereafter accrued attributable to the lost interest on an  
43 acreage basis, of that portion of oil and gas thereafter produced and marketed (excluding production  
44 from any wells thereafter drilled) which, in the absence of such lease termination, would be attributable  
45 to the lost interest on an acreage basis, up to the amount of unrecovered costs, the proceeds of said  
46 portion of the oil and gas to be contributed by the other parties in proportion to their respective in-  
47 terests; and

48 (c) Any monies, up to the amount of unrecovered costs, that may be paid by any party who is, or  
49 becomes, the owner of the interest lost, for the privilege of participating in the Contract Area or be-  
50 coming a party to this agreement.  
51

52 3. Other Losses: All losses incurred, other than those set forth in Articles IV.B.1. and IV.B.2.  
53 above, shall not be considered failure of title but shall be joint losses and shall be borne by all parties  
54 in proportion to their interests. There shall be no readjustment of interests in the remaining portion of  
55 the Contract Area.  
56

57 **ARTICLE V.**  
58 **OPERATOR**

59  
60 **A. DESIGNATION AND RESPONSIBILITIES OF OPERATOR:**

61  
62 Annex Petroleum, Inc. shall be the  
63 Operator of the Contract Area, and shall conduct and direct and have full control of all operations on  
64 the Contract Area as permitted and required by, and within the limits of, this agreement. It shall con-  
65 duct all such operations in a good and workmanlike manner, but it shall have no liability as Operator  
66 to the other parties for losses sustained or liabilities incurred, except such as may result from gross  
67 negligence or willful misconduct.  
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1 **B. Resignation or Removal of Operator and Selection of Successor:**

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1. Resignation or Removal of Operator: Operator may resign at any time by giving written notice thereof to Non-Operators. If Operator terminates its legal existence, no longer owns an interest in the Contract Area, or is no longer capable of serving as Operator, it shall cease to be Operator without any action by Non-Operator, except the selection of a successor. Operator may be removed if it fails or refuses to carry out its duties hereunder, or becomes insolvent, bankrupt or is placed in receivership, by the affirmative vote of two (2) or more Non-Operators owning a majority interest based on ownership as shown on Exhibit "A", ~~and not on the number of parties remaining~~ after excluding the voting interest of Operator. Such resignation or removal shall not become effective until 7:00 o'clock A.M. on the first day of the calendar month following the expiration of ninety (90) days after the giving of notice of resignation by Operator or action by the Non-Operators to remove Operator, unless a successor Operator has been selected and assumes the duties of Operator at an earlier date. Operator, after effective date of resignation or removal, shall be bound by the terms hereof as a Non-Operator. A change of a corporate name or structure of Operator or transfer of Operator's interest to any single subsidiary, parent or successor corporation shall not be the basis for removal of Operator.

2. Selection of Successor Operator: Upon the resignation or removal of Operator, a successor Operator shall be selected by the Parties. The successor Operator shall be selected from the parties owning an interest in the Contract Area at the time such successor Operator is selected. If the Operator that is removed fails to vote or votes only to succeed itself, the successor Operator shall be selected by the affirmative vote of two (2) or more parties owning a majority interest based on ownership as shown on Exhibit "A", ~~and not on the number of parties remaining~~ after excluding the voting interest of the Operator that was removed.

**C. Employees:**

The number of employees used by Operator in conducting operations hereunder, their selection, and the hours of labor and the compensation for services performed, shall be determined by Operator, and all such employees shall be the employees of Operator.

**D. Drilling Contracts:**

All wells drilled on the Contract Area shall be drilled on a competitive contract basis at the usual rates prevailing in the area. If it so desires, Operator may employ its own tools and equipment in the drilling of wells, but its charges therefor shall not exceed the prevailing rates in the area and the rate of such charges shall be agreed upon by the parties in writing before drilling operations are commenced, and such work shall be performed by Operator under the same terms and conditions as are customary and usual in the area in contracts of independent contractors who are doing work of a similar nature.

**ARTICLE VI.  
DRILLING AND DEVELOPMENT**

**A. Initial Well:**

On or before the 31st day of December, 1983, Operator shall commence the drilling of a well for oil and gas at the following location:

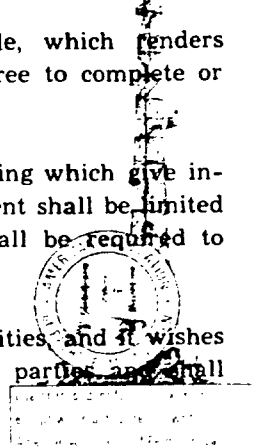
SE 1/4 SE 1/4 of Section 28, T-23-S, R-28-E, N.M.P.M.  
Eddy County, New Mexico

and shall thereafter continue the drilling of the well with due diligence to 7,200 feet or a depth sufficient to adequately test the Bone Spring formation, whichever is the lesser depth

unless granite or other practically impenetrable substance or condition in the hole, which renders further drilling impractical, is encountered at a lesser depth, or unless all parties agree to complete or abandon the well at a lesser depth.

Operator shall make reasonable tests of all formations encountered during drilling which give indication of containing oil and gas in quantities sufficient to test, unless this agreement shall be limited in its application to a specific formation or formations, in which event Operator shall be required to test only the formation or formations to which this agreement may apply.

If, in Operator's judgment, the well will not produce oil or gas in paying quantities, and it wishes to plug and abandon the well as a dry hole, it shall first secure the consent of all parties and shall plug and abandon same as provided in Article VI.E.1. hereof.



1 **B. Subsequent Operations:**

2  
 3 1. Proposed Operations: Should any party hereto desire to drill any well on the Contract Area  
 4 other than the well provided for in Article VI.A., or to rework, deepen or plug back a dry hole drilled  
 5 at the joint expense of all parties or a well jointly owned by all the parties and not then producing  
 6 in paying quantities, the party desiring to drill, rework, deepen or plug back such a well shall give the  
 7 other parties written notice of the proposed operation, specifying the work to be performed, the loca-  
 8 tion, proposed depth, objective formation and the estimated cost of the operation. The parties receiv-  
 9 ing such a notice shall have thirty (30) days after receipt of the notice within which to notify the  
 10 parties wishing to do the work whether they elect to participate in the cost of the proposed operation.  
 11 If a drilling rig is on location, notice of proposal to rework, plug back or drill deeper may be given  
 12 by telephone and the response period shall be limited to forty-eight (48) hours, exclusive of Saturday,  
 13 Sunday or legal holidays. Failure of a party receiving such notice to reply within the period above fixed  
 14 shall constitute an election by that party not to participate in the cost of the proposed operation. Any  
 15 notice or response given by telephone shall be promptly confirmed in writing.

16  
 17 2. Operations by Less than All Parties: If any party receiving such notice as provided in Article  
 18 VI.B.1. or VI.E.1. elects not to participate in the proposed operation, then, in order to be entitled to  
 19 the benefits of this article, the party or parties giving the notice and such other parties as shall elect  
 20 to participate in the operation shall, within sixty (60) days after the expiration of the notice period of  
 21 thirty (30) days (or as promptly as possible after the expiration of the forty-eight (48) hour period  
 22 where the drilling rig is on location, as the case may be) actually commence work on the proposed  
 23 operation and complete it with due diligence. Operator shall perform all work for the account of the  
 24 Consenting Parties; provided, however, if no drilling rig or other equipment is on location, and if Op-  
 25 erator is a Non-Consenting Party, the Consenting Parties shall either: (a) request Operator to perform  
 26 the work required by such proposed operation for the account of the Consenting Parties, or (b) desig-  
 27 nate one (1) of the Consenting Parties as Operator to perform such work. Consenting Parties, when  
 28 conducting operations on the Contract Area pursuant to this Article VI.B.2., shall comply with all terms  
 29 and conditions of this agreement.

30  
 31 If less than all parties approve any proposed operation, the proposing party, immediately after the  
 32 expiration of the applicable notice period, shall advise the Consenting Parties of (a) the total interest  
 33 of the parties approving such operation, and (b) its recommendation as to whether the Consenting Par-  
 34 ties should proceed with the operation as proposed. Each Consenting Party, within forty-eight (48)  
 35 hours (exclusive of Saturday, Sunday or legal holidays) after receipt of such notice, shall advise the  
 36 proposing party of its desire to (a) limit participation to such party's interest as shown on Exhibit "A",  
 37 or (b) carry its proportionate part of Non-Consenting Parties' interest. The proposing party, at its  
 38 election, may withdraw such proposal if there is insufficient participation, and shall promptly notify  
 39 all parties of such decision.

40  
 41 The entire cost and risk of conducting such operations shall be borne by the Consenting Parties in  
 42 the proportions they have elected to bear same under the terms of the preceding paragraph. Consenting  
 43 Parties shall keep the leasehold estates involved in such operations free and clear of all liens and  
 44 encumbrances of every kind created by or arising from the operations of the Consenting Parties. If such  
 45 an operation results in a dry hole, the Consenting Parties shall plug and abandon the well at their sole  
 46 cost, risk and expense. If any well drilled, reworked, deepened or plugged back under the provisions  
 47 of this Article results in a producer of oil and/or gas in paying quantities, the Consenting Parties shall  
 48 complete and equip the well to produce at their sole cost and risk, and the well shall then be turned  
 49 over to Operator and shall be operated by it at the expense and for the account of the Consenting Parties.  
 50 Upon commencement of operations for the drilling, reworking, deepening or plugging back of any such  
 51 well by Consenting Parties in accordance with the provisions of this Article, each Non-Consenting Party  
 52 shall be deemed to have relinquished to Consenting Parties, and the Consenting Parties shall own and  
 53 be entitled to receive, in proportion to their respective interests, all of such Non-Consenting Party's  
 54 interest in the well and share of production therefrom until the proceeds of the sale of such share,  
 55 calculated at the well, or market value thereof if such share is not sold (after deducting production  
 56 taxes, royalty, overriding royalty and other interests existing on the effective date hereof, payable out of  
 57 or measured by the production from such well accruing with respect to such interest until it reverts)  
 58 shall equal the total of the following:

59  
 60 (a) 100% of each such Non-Consenting Party's share of the cost of any newly acquired surface  
 61 equipment beyond the wellhead connections (including, but not limited to, stock tanks, separators,  
 62 treaters, pumping equipment and piping), plus 100% of each such Non-Consenting Party's share of the  
 63 cost of operation of the well commencing with first production and continuing until each such Non-  
 64 Consenting Party's relinquished interest shall revert to it under other provisions of this Article, it being  
 65 agreed that each Non-Consenting Party's share of such costs and equipment will be that interest which  
 66 would have been chargeable to each Non-Consenting Party had it participated in the well from the be-  
 67 ginning of the operation; and

68  
 69 (b) 300% of that portion of the costs and expenses of drilling reworking, deepening, or plugging  
 70 back, testing and completing, after deducting any cash contributions received under Article VIII.C., and

1 300% of that portion of the cost of newly acquired equipment in the well (to and including the well-  
2 head connections), which would have been chargeable to such Non-Consenting Party if it had partici-  
3 pated therein.

4  
5 Gas production attributable to any Non - Consenting Party's relinquished interest upon such Party's  
6 election, shall be sold to its purchaser, if available, under the terms of its existing gas sales con-  
7 tract. Such Non - Consenting Party shall direct its purchaser to remit the proceeds receivable from  
8 such sale direct to the Consenting Parties until the amounts provided for in this Article are recov-  
9 ered from the Non - Consenting Party's relinquished interest. If such Non - Consenting Party has not  
10 contracted for sale of its gas at the time such gas is available for delivery, or has not made the elec-  
11 tion as provided above, the Consenting Parties shall own and be entitled to receive and sell such Non-  
12 Consenting Party's share of gas as hereinabove provided during the recoupment period.

13  
14 During the period of time Consenting Parties are entitled to receive Non-Consenting Party's share  
15 of production, or the proceeds therefrom, Consenting Parties shall be responsible for the payment of  
16 all production, severance, gathering and other taxes, and all royalty, overriding royalty and other  
17 burdens applicable to Non-Consenting Party's share of production.

18  
19 In the case of any reworking, plugging back or deeper drilling operation, the Consenting Parties shall  
20 be permitted to use, free of cost, all casing, tubing and other equipment in the well, but the ownership of  
21 all such equipment shall remain unchanged; and upon abandonment of a well after such reworking,  
22 plugging back or deeper drilling, the Consenting Parties shall account for all such equipment to the  
23 owners thereof, with each party receiving its proportionate part in kind or in value, less cost of  
24 salvage.

25  
26 Within sixty (60) days after the completion of any operation under this Article, the party con-  
27 ducting the operations for the Consenting Parties shall furnish each Non-Consenting Party with an in-  
28 ventory of the equipment in and connected to the well, and an itemized statement of the cost of drilling,  
29 deepening, plugging back, testing, completing, and equipping the well for production; or, at its option,  
30 the operating party, in lieu of an itemized statement of such costs of operation, may submit a detailed  
31 statement of monthly billings. Each month thereafter, during the time the Consenting Parties are being  
32 reimbursed as provided above, the Party conducting the operations for the Consenting Parties shall furn-  
33 ish the Non-Consenting Parties with an itemized statement of all costs and liabilities incurred in the  
34 operation of the well, together with a statement of the quantity of oil and gas produced from it and the  
35 amount of proceeds realized from the sale of the well's working interest production during the preceding  
36 month. In determining the quantity of oil and gas produced during any month, Consenting Parties  
37 shall use industry accepted methods such as, but not limited to, metering or periodic well tests. Any  
38 amount realized from the sale or other disposition of equipment newly acquired in connection with any  
39 such operation which would have been owned by a Non-Consenting Party had it participated therein  
40 shall be credited against the total unreturned costs of the work done and of the equipment purchased,  
41 in determining when the interest of such Non-Consenting Party shall revert to it as above provided;  
42 and if there is a credit balance, it shall be paid to such Non-Consenting party.

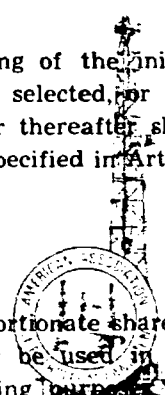
43  
44 If and when the Consenting Parties recover from a Non-Consenting Party's relinquished interest  
45 the amounts provided for above, the relinquished interests of such Non-Consenting Party shall auto-  
46 matically revert to it, and, from and after such reversion, such Non-Consenting Party shall own the same  
47 interest in such well, the material and equipment in or pertaining thereto, and the production there-  
48 from as such Non-Consenting Party would have been entitled to had it participated in the drilling,  
49 reworking, deepening or plugging back of said well. Thereafter, such Non-Consenting Party shall be  
50 charged with and shall pay its proportionate part of the further costs of the operation of said well in  
51 accordance with the terms of this agreement and the Accounting Procedure, attached hereto.

52  
53 Notwithstanding the provisions of this Article VI.B.2., it is agreed that without the mutual consent  
54 of all parties, no wells shall be completed in or produced from a source of supply from which a well  
55 located elsewhere on the Contract Area is producing, unless such well conforms to the then-existing  
56 well spacing pattern for such source of supply.

57  
58 The provisions of this Article shall have no application whatsoever to the drilling of the initial  
59 well described in Article VI.A. except (a) when Option 2, Article VII.D.1., has been selected, or (b)  
60 to the reworking, deepening and plugging back of such initial well, if such well is or thereafter shall  
61 prove to be a dry hole or non-commercial well, after having been drilled to the depth specified in Article  
62 VI.A.

63  
64 **C. Right to Take Production in Kind:**

65  
66 Each party shall have the right to take in kind or separately dispose of its proportionate share of  
67 all oil and gas produced from the Contract Area, exclusive of production which may be used in de-  
68 velopment and producing operations and in preparing and treating oil for marketing purposes and  
69 production unavoidably lost. Any extra expenditure incurred in the taking in kind or separate dispo-  
70 sition by any party of its proportionate share of the production shall be borne by such party. Any





1 party taking its share of production in kind shall be required to pay for only its proportionate share  
 2 of such part of Operator's surface facilities which it uses.

3  
 4 Each party shall execute such division orders and contracts as may be necessary for the sale of its  
 5 interest in production from the Contract Area, and, except as provided in Article VII.B., shall be entitled  
 6 to receive payment direct from the purchaser thereof for its share of all production.

7  
 8 In the event any party shall fail to make the arrangements necessary to take in kind or separately  
 9 dispose of its proportionate share of the oil and gas produced from the Contract Area, Operator shall have  
 10 the right, subject to the revocation at will by the party owning it, but not the obligation, to purchase such  
 11 oil and gas or sell it to others at any time and from time to time, for the account of the non-taking  
 12 party at the best price obtainable in the area for such production. Any such purchase or sale by Op-  
 13 erator shall be subject always to the right of the owner of the production to exercise at any time its  
 14 right to take in kind, or separately dispose of, its share of all oil and gas not previously delivered to a  
 15 purchaser. Any purchase or sale by Operator of any other party's share of oil and gas shall be only for  
 16 such reasonable periods of time as are consistent with the minimum needs of the industry under the  
 17 particular circumstances, but in no event for a period in excess of one (1) year. Notwithstanding the  
 18 foregoing, Operator shall not make a sale, including one into interstate commerce, of any other party's  
 19 share of gas production without first giving such other party thirty (30) days notice of such intended  
 20 sale.

21  
 22 In the event one or more parties' separate disposition of its share of the gas causes split-stream de-  
 23 liveries to separate pipelines and or deliveries which on a day-to-day basis for any reason are not  
 24 exactly equal to a party's respective proportionate share of total gas sales to be allocated to it, the  
 25 balancing or accounting between the respective accounts of the parties shall be in accordance with  
 26 any Gas Balancing Agreement between the parties hereto, whether such Agreement is attached as  
 27 Exhibit "E", or is a separate Agreement.

28  
 29 **D. Access to Contract Area and Information:**

30  
 31 Each party shall have access to the Contract Area at all reasonable times, at its sole risk to inspect  
 32 or observe operations, and shall have access at reasonable times to information pertaining to the de-  
 33 velopment or operation thereof, including Operator's books and records relating thereto. Operator, upon  
 34 request, shall furnish each of the other parties with copies of all forms or reports filed with govern-  
 35 mental agencies, daily drilling reports, well logs, tank tables, daily gauge and run tickets and reports  
 36 of stock on hand at the first of each month, and shall make available samples of any cores or cuttings  
 37 taken from any well drilled on the Contract Area. The cost of gathering and furnishing information to  
 38 Non-Operator, other than that specified above, shall be charged to the Non-Operator that requests the  
 39 information.

40  
 41 **E. Abandonment of Wells:**

42  
 43 1. Abandonment of Dry Holes: Except for any well drilled pursuant to Article VI.B.2., any well  
 44 which has been drilled under the terms of this agreement and is proposed to be completed as a dry hole  
 45 shall not be plugged and abandoned without the consent of all parties. Should Operator, after diligent  
 46 effort, be unable to contact any party, or should any party fail to reply within forty-eight (48) hours  
 47 (exclusive of Saturday, Sunday or legal holidays) after receipt of notice of the proposal to plug and  
 48 abandon such well, such party shall be deemed to have consented to the proposed abandonment. All  
 49 such wells shall be plugged and abandoned in accordance with applicable regulations and at the cost,  
 50 risk and expense of the parties who participated in the cost of drilling of such well. Any party who ob-  
 51 jects to the plugging and abandoning such well shall have the right to take over the well and conduct  
 52 further operations in search of oil and/or gas subject to the provisions of Article VI.B.

53  
 54 2. Abandonment of Wells that have Produced: Except for any well which has been drilled or re-  
 55 worked pursuant to Article VI.B.2. hereof for which the Consenting Parties have not been fully reim-  
 56 bursed as therein provided, any well which has been completed as a producer shall not be plugged and  
 57 abandoned without the consent of all parties. If all parties consent to such abandonment, the well shall  
 58 be plugged and abandoned in accordance with applicable regulations and at the cost, risk and expense  
 59 of all the parties hereto. If, within thirty (30) days after receipt of notice of the proposed abandonment  
 60 of such well, all parties do not agree to the abandonment of any well, those wishing to continue its op-  
 61 eration shall tender to each of the other parties its proportionate share of the value of the well's salvageable  
 62 material and equipment, determined in accordance with the provisions of Exhibit "C", less the estimated  
 63 cost of salvaging and the estimated cost of plugging and abandoning. Each abandoning party shall  
 64 assign to the non-abandoning parties, without warranty, express or implied, as to title or as to quantity,  
 65 quality, or fitness for use of the equipment and material, all of its interest in the well and related equip-  
 66 ment, together with its interest in the leasehold estate as to, but only as to, the interval or intervals of the  
 67 formation or formations then open to production. If the interest of the abandoning party or parties includes  
 68 an oil and gas interest, such party shall execute and deliver to the non-abandoning party or parties an  
 69 oil and gas lease, limited to the interval or intervals of the formation or formations then open to produc-  
 70 tion, for a term of one year and so long thereafter as oil and/or gas is produced from the interval or inter-

1 vals of the formation or formations covered thereby, such lease to be on the form attached as Exhibit  
2 "B". The assignments or leases so limited shall encompass the "drilling unit" upon which the well is  
3 located. The payments by, and the assignments or leases to, the assignees shall be in a ratio based upon  
4 the relationship of their respective percentages of participation in the Contract Area to the aggregate of  
5 the percentages of participation in the Contract Area of all assignees. There shall be no readjustment  
6 of interest in the remaining portion of the Contract Area.

7  
8 Thereafter, abandoning parties shall have no further responsibility, liability, or interest in the op-  
9 eration of or production from the well in the interval or intervals then open other than the royalties  
10 retained in any lease made under the terms of this Article. Upon request, Operator shall continue to  
11 operate the assigned well for the account of the non-abandoning parties at the rates and charges con-  
12 templated by this agreement, plus any additional cost and charges which may arise as the result of  
13 the separate ownership of the assigned well.

14  
15 **ARTICLE VII.**  
16 **EXPENDITURES AND LIABILITY OF PARTIES**

17  
18 **A. Liability of Parties:**

19  
20 The liability of the parties shall be several, not joint or collective. Each party shall be responsible  
21 only for its obligations, and shall be liable only for its proportionate share of the costs of developing  
22 and operating the Contract Area. Accordingly, the liens granted among the parties in Article VII.B. are  
23 given to secure only the debts of each severally. It is not the intention of the parties to create, nor shall  
24 this agreement be construed as creating, a mining or other partnership or association, or to render the  
25 parties liable as partners.

26  
27 **B. Liens and Payment Defaults:**

28  
29 Each Non-Operator grants to Operator a lien upon its oil and gas rights in the Contract Area, and a  
30 security interest in its share of oil and or gas when extracted and its interest in all equipment, to secure  
31 payment of its share of expense, together with interest thereon at the rate provided in the Accounting  
32 Procedure attached hereto as Exhibit "C". To the extent that Operator has a security interest under the  
33 Uniform Commercial Code of the State, Operator shall be entitled to exercise the rights and remedies  
34 of a secured party under the Code. The bringing of a suit and the obtaining of judgment by Operator  
35 for the secured indebtedness shall not be deemed an election of remedies or otherwise affect the lien  
36 rights or security interest as security for the payment thereof. In addition, upon default by any Non-  
37 Operator in the payment of its share of expense, Operator shall have the right, without prejudice to  
38 other rights or remedies, to collect from the purchaser the proceeds from the sale of such Non-Operator's  
39 share of oil and/or gas until the amount owed by such Non-Operator, plus interest has been paid. Each  
40 purchaser shall be entitled to rely upon Operator's written statement concerning the amount of any de-  
41 fault. Operator grants a like lien and security interest to the Non-Operators to secure payment of Op-  
42 erator's proportionate share of expense.

43  
44 If any party fails or is unable to pay its share of expense within sixty (60) days after rendition of  
45 a statement therefor by Operator, the non-defaulting parties, including Operator, shall, upon request by  
46 Operator, pay the unpaid amount in the proportion that the interest of each such party bears to the in-  
47 terest of all such parties. Each party so paying its share of the unpaid amount shall, to obtain reimburse-  
48 ment thereof, be subrogated to the security rights described in the foregoing paragraph.

49  
50 **C. Payments and Accounting:**

51  
52 Except as herein otherwise specifically provided, Operator shall promptly pay and discharge expenses  
53 incurred in the development and operation of the Contract Area pursuant to this agreement and shall  
54 charge each of the parties hereto with their respective proportionate shares upon the expense basis pro-  
55 vided in the Accounting Procedure attached hereto as Exhibit "C". Operator shall keep an accurate  
56 record of the joint account hereunder, showing expenses incurred and charges and credits made and  
57 received.

58  
59 Operator, at its election, shall have the right from time to time to demand and receive from the  
60 other parties payment in advance of their respective shares of the estimated amount of the expense to  
61 be incurred in operations hereunder during the next succeeding month, which right may be exercised only  
62 by submission to each such party of an itemized statement of such estimated expense, together with  
63 an invoice for its share thereof. Each such statement and invoice for the payment in advance of esti-  
64 mated expense shall be submitted on or before the 20th day of the next preceding month. Each party  
65 shall pay to Operator its proportionate share of such estimate within fifteen (15) days after such es-  
66 timate and invoice is received. If any party fails to pay its share of said estimate within said time, the  
67 amount due shall bear interest as provided in Exhibit "C" until paid. Proper adjustment shall be  
68 made monthly between advances and actual expense to the end that each party shall bear and pay its  
69 proportionate share of actual expenses incurred, and no more.

1 **D. Limitation of Expenditures:**

2  
3 1. Drill or Deepen: Without the consent of all parties, no well shall be drilled or deepened, ex-  
4 cept any well drilled or deepened pursuant to the provisions of Article VI.B.2. of this Agreement, it being  
5 understood that the consent to the drilling or deepening shall include:

6  
7  Option No. 1: All necessary expenditures for the drilling or deepening, testing, completing and  
8 equipping of the well, including necessary tankage and/or surface facilities.

9  
10  Option No. 2: All necessary expenditures for the drilling or deepening and testing of the well. When  
11 such well has reached its authorized depth, and all tests have been completed, Operator shall give im-  
12 mediate notice to the Non-Operators who have the right to participate in the completion costs. The parties  
13 receiving such notice shall have forty-eight (48) hours (exclusive of Saturday, Sunday and legal holi-  
14 days) in which to elect to participate in the setting of casing and the completion attempt. Such election,  
15 when made, shall include consent to all necessary expenditures for the completing and equipping of such  
16 well, including necessary tankage and/or surface facilities. Failure of any party receiving such notice  
17 to reply within the period above fixed shall constitute an election by that party not to participate in  
18 the cost of the completion attempt. If one or more, but less than all of the parties, elect to set pipe and  
19 to attempt a completion, the provisions of Article VI.B.2. hereof (the phrase "reworking, deepening or  
20 plugging back" as contained in Article VI.B.2. shall be deemed to include "completing") shall apply to  
21 the operations thereafter conducted by less than all parties.

22  
23 2. Rework or Plug Back: Without the consent of all parties, no well shall be reworked or plugged  
24 back except a well reworked or plugged back pursuant to the provisions of Article VI.B.2. of this agree-  
25 ment, it being understood that the consent to the reworking or plugging back of a well shall include  
26 consent to all necessary expenditures in conducting such operations and completing and equipping of  
27 said well, including necessary tankage and or surface facilities.

28  
29 3. Other Operations: Operator shall not undertake any single project reasonably estimated to require  
30 an expenditure in excess of Fifteen Thousand and no/100----- Dollars (\$15,000.00)  
31 except in connection with a well, the drilling, reworking, deepening, completing, recompleting, or plug-  
32 ging back of which has been previously authorized by or pursuant to this agreement: provided, how-  
33 ever, that, in case of explosion, fire, flood or other sudden emergency, whether of the same or different  
34 nature. Operator may take such steps and incur such expenses as in its opinion are required to deal with  
35 the emergency to safeguard life and property but Operator, as promptly as possible, shall report the emer-  
36 gency to the other parties. If Operator prepares "Authority for Expenditures" for its own use,  
37 Operator, upon request, shall furnish copies of its "Authority for Expenditures" for any single project  
38 costing in excess of Five Thousand and no/100----- Dollars (\$5,000.00).

39  
40 **E. Royalties, Overriding Royalties and Other Payments:**

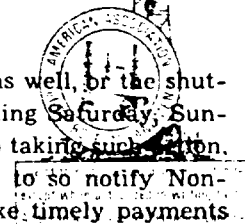
41  
42 Each party shall pay or deliver, or cause to be paid or delivered, all royalties to the extent of  
43 one-eighth (1/8) royalty due on its share of production and shall hold the other parties free  
44 from any liability therefor. If the interest of any party in any oil and gas lease covered by this agree-  
45 ment is subject to any royalty, overriding royalty, production payment, or other charge over and above  
46 the aforesaid royalty, such party shall assume and alone bear all such obligations and shall account  
47 for or cause to be accounted for, such interest to the owners thereof.

48  
49 No party shall ever be responsible, on any price basis higher than the price received by such party,  
50 to any other party's lessor or royalty owner; and if any such other party's lessor or royalty owner should  
51 demand and receive settlements on a higher price basis, the party contributing such lease shall bear the  
52 royalty burden insofar as such higher price is concerned.

53  
54 **F. Rentals, Shut-in Well Payments and Minimum Royalties:**

55  
56 Rentals, shut-in well payments and minimum royalties which may be required under the terms of  
57 any lease shall be paid by the party or parties who subjected such lease to this agreement at its or their  
58 expense. In the event two or more parties own and have contributed interests in the same lease to this  
59 agreement, such parties may designate one of such parties to make said payments for and on behalf of all  
60 such parties. Any party may request, and shall be entitled to receive, proper evidence of all such pay-  
61 ments. In the event of failure to make proper payment of any rental, shut-in well payment or minimum  
62 royalty through mistake or oversight where such payment is required to continue the lease in force,  
63 any loss which results from such non-payment shall be borne in accordance with the provisions of Article  
64 IV.B.2.

65  
66 Operator shall notify Non-Operator of the anticipated completion of a shut-in gas well, or the shut-  
67 ting in or return to production of a producing gas well, at least five (5) days (excluding Saturday, Sun-  
68 day and holidays), or at the earliest opportunity permitted by circumstances, prior to taking such action,  
69 but assumes no liability for failure to do so. In the event of failure by Operator to so notify Non-  
70 Operator, the loss of any lease contributed hereto by Non-Operator for failure to make timely payments



1 of any shut-in well payment shall be borne jointly by the parties hereto under the provisions of Article  
2 IV.B.3.

3  
4 **G. Taxes:**

5 (Subject to Article XV., paragraph A.)

6 Beginning with the first calendar year after the effective date hereof, Operator shall render for ad  
7 valorem taxation all property subject to this agreement which by law should be rendered for such  
8 taxes, and it shall pay all such taxes assessed thereon before they become delinquent. Prior to the ren-  
9 dition date, each Non-Operator shall furnish Operator information as to burdens (to include, but not be  
10 limited to, royalties, overriding royalties and production payments) on leases and oil and gas interests con-  
11 tributed by such Non-Operator. If the assessed valuation of any leasehold estate is reduced by reason of its  
12 being subject to outstanding excess royalties, overriding royalties or production payments, the reduction in  
13 ad valorem taxes resulting therefrom shall inure to the benefit of the owner or owners of such leasehold  
14 estate, and Operator shall adjust the charge to such owner or owners so as to reflect the benefit of such  
15 reduction. Operator shall bill other parties for their proportionate share of all tax payments in the man-  
16 ner provided in Exhibit "C".

17  
18 If Operator considers any tax assessment improper, Operator may, at its discretion, protest within  
19 the time and manner prescribed by law, and prosecute the protest to a final determination, unless all  
20 parties agree to abandon the protest prior to final determination. During the pendency of administrative  
21 or judicial proceedings, Operator may elect to pay, under protest, all such taxes and any interest and  
22 penalty. When any such protested assessment shall have been finally determined, Operator shall pay  
23 the tax for the joint account, together with any interest and penalty accrued, and the total cost shall then  
24 be assessed against the parties, and be paid by them, as provided in Exhibit "C".

25  
26 Each party shall pay or cause to be paid all production, severance, gathering and other taxes im-  
27 posed upon or with respect to the production or handling of such party's share of oil and/or gas pro-  
28 duced under the terms of this agreement.

29  
30 **H. Insurance:**

31  
32 At all times while operations are conducted hereunder, Operator shall comply with the Workmen's  
33 Compensation Law of the State where the operations are being conducted; provided, however, that Op-  
34 erator may be a self-insurer for liability under said compensation laws in which event the only charge  
35 that shall be made to the joint account shall be an amount equivalent to the premium which would have  
36 been paid had such insurance been obtained. Operator shall also carry or provide insurance for the  
37 benefit of the joint account of the parties as outlined in Exhibit "D", attached to and made a part hereof.  
38 Operator shall require all contractors engaged in work on or for the Contract Area to comply with the  
39 Workmen's Compensation Law of the State where the operations are being conducted and to maintain  
40 such other insurance as Operator may require.

41  
42 In the event Automobile Public Liability Insurance is specified in said Exhibit "D", or subsequently  
43 receives the approval of the parties, no direct charge shall be made by Operator for premiums paid for  
44 such insurance for Operator's fully owned automotive equipment.

45  
46 **ARTICLE VIII.**  
47 **ACQUISITION, MAINTENANCE OR TRANSFER OF INTEREST**

48  
49 **A. Surrender of Leases:**

50  
51 The leases covered by this agreement, insofar as they embrace acreage in the Contract Area, shall  
52 not be surrendered in whole or in part unless all parties consent thereto.

53  
54 However, should any party desire to surrender its interest in any lease or in any portion thereof, and  
55 other parties do not agree or consent thereto, the party desiring to surrender shall assign, without express  
56 or implied warranty of title, all of its interest in such lease, or portion thereof, and any well, material and  
57 equipment which may be located thereon and any rights in production thereafter secured, to the parties  
58 not desiring to surrender it. If the interest of the assigning party includes an oil and gas interest, the as-  
59 signing party shall execute and deliver to the party or parties not desiring to surrender an oil and gas  
60 lease covering such oil and gas interest for a term of one year and so long thereafter as oil and/or gas  
61 is produced from the land covered thereby, such lease to be on the form attached hereto as Exhibit "B".  
62 Upon such assignment, the assigning party shall be relieved from all obligations thereafter accruing,  
63 but not theretofore accrued, with respect to the acreage assigned and the operation of any well thereon,  
64 and the assigning party shall have no further interest in the lease assigned and its equipment and pro-  
65 duction other than the royalties retained in any lease made under the terms of this Article. The parties  
66 assignee shall pay to the party assignor the reasonable salvage value of the latter's interest in any wells  
67 and equipment on the assigned acreage. The value of all material shall be determined in accordance  
68 with the provisions of Exhibit "C", less the estimated cost of salvaging and the estimated cost of dig-  
69 ging and abandoning. If the assignment is in favor of more than one party, the assigned interest shall

1 be shared by the parties assignee in the proportions that the interest of each bears to the interest of all  
2 parties assignee.

3  
4 Any assignment or surrender made under this provision shall not reduce or change the assignor's or  
5 surrendering parties' interest, as it was immediately before the assignment, in the balance of the Contract  
6 Area; and the acreage assigned or surrendered, and subsequent operations thereon, shall not thereafter  
7 be subject to the terms and provisions of this agreement.

8  
9 **B. Renewal or Extension of Leases:**

10  
11 If any party secures a renewal of any oil and gas lease subject to this Agreement, all other parties  
12 shall be notified promptly, and shall have the right for a period of thirty (30) days following receipt  
13 of such notice in which to elect to participate in the ownership of the renewal lease, insofar as such  
14 lease affects lands within the Contract Area, by paying to the party who acquired it their several proper  
15 proportionate shares of the acquisition cost allocated to that part of such lease within the Contract Area,  
16 which shall be in proportion to the interests held at that time by the parties in the Contract Area.

17  
18 If some, but less than all, of the parties elect to participate in the purchase of a renewal lease, it  
19 shall be owned by the parties who elect to participate therein, in a ratio based upon the relationship of  
20 their respective percentage of participation in the Contract Area to the aggregate of the percentages  
21 of participation in the Contract Area of all parties participating in the purchase of such renewal lease.  
22 Any renewal lease in which less than all parties elect to participate shall not be subject to this agreement.

23  
24 Each party who participates in the purchase of a renewal lease shall be given an assignment of its  
25 proportionate interest therein by the acquiring party.

26  
27 The provisions of this Article shall apply to renewal leases whether they are for the entire interest  
28 covered by the expiring lease or cover only a portion of its area or an interest therein. Any renewal lease  
29 taken before the expiration of its predecessor lease, or taken or contracted for within six (6) months after  
30 the expiration of the existing lease shall be subject to this provision; but any lease taken or contracted  
31 for more than six (6) months after the expiration of an existing lease shall not be deemed a renewal  
32 lease and shall not be subject to the provisions of this agreement.

33  
34 The provisions in this Article shall apply also and in like manner to extensions of oil and gas  
35 leases.

36  
37 **C. Acreage or Cash Contributions:**

38  
39 While this agreement is in force, if any party contracts for a contribution of cash toward the drilling  
40 of a well or any other operation on the Contract Area, such contribution shall be paid to the party who  
41 conducted the drilling or other operation and shall be applied by it against the cost of such drilling or  
42 other operation. If the contribution be in the form of acreage, the party to whom the contribution is  
43 made shall promptly tender an assignment of the acreage, without warranty of title, to the Drilling  
44 Parties in the proportions said Drilling Parties shared the cost of drilling the well. If all parties hereto  
45 are Drilling Parties and accept such tender, such acreage shall become a part of the Contract Area and  
46 be governed by the provisions of this agreement. If less than all parties hereto are Drilling Parties and  
47 accept such tender, such acreage shall not become a part of the Contract Area. Each party shall promptly  
48 notify all other parties of all acreage or money contributions it may obtain in support of any well or  
49 any other operation on the Contract Area.

50  
51 If any party contracts for any consideration relating to disposition of such party's share of substances  
52 produced hereunder, such consideration shall not be deemed a contribution as contemplated in this  
53 Article VIII.C.

54  
55 **D. Subsequently Created Interest:**

56  
57 Notwithstanding the provisions of Article VIII.E. and VIII.G., if any party hereto shall, subsequent  
58 to execution of this agreement, create an overriding royalty, production payment, or net proceeds interest,  
59 which such interests are hereinafter referred to as "subsequently created interest", such subsequently  
60 created interest shall be specifically made subject to all of the terms and provisions of this agreement, as  
61 follows:

62  
63 1. If non-consent operations are conducted pursuant to any provision of this agreement, and the  
64 party conducting such operations becomes entitled to receive the production attributable to the interest  
65 out of which the subsequently created interest is derived, such party shall receive same free and clear  
66 of such subsequently created interest. The party creating same shall bear and pay all such subsequently  
67 created interests and shall indemnify and hold the other parties hereto free and harmless from any and  
68 all liability resulting therefrom.

2. If the owner of the interest from which the subsequently created interest is derived (1) fails to pay, when due, its share of expenses chargeable hereunder, or (2) elects to abandon a well under provisions of Article VI.E. hereof, or (3) elects to surrender a lease under provisions of Article VIII.A. hereof, the subsequently created interest shall be chargeable with the pro rata portion of all expenses hereunder in the same manner as if such interest were a working interest. For purposes of collecting such chargeable expenses, the party or parties who receive assignments as a result of (2) or (3) above shall have the right to enforce all provisions of Article VII.B. hereof against such subsequently created interest.

**E. Maintenance of Uniform Interest:**

For the purpose of maintaining uniformity of ownership in the oil and gas leasehold interests covered by this agreement, and notwithstanding any other provisions to the contrary, no party shall sell, encumber, transfer or make other disposition of its interest in the leases embraced within the Contract Area and in wells, equipment and production unless such disposition covers either:

- 1. the entire interest of the party in all leases and equipment and production; or
- 2. an equal undivided interest in all leases and equipment and production in the Contract Area.

Every such sale, encumbrance, transfer or other disposition made by any party shall be made expressly subject to this agreement, and shall be made without prejudice to the right of the other parties.

If, at any time the interest of any party is divided among and owned by four or more co-owners, Operator, at its discretion, may require such co-owners to appoint a single trustee or agent with full authority to receive notices, approve expenditures, receive billings for and approve and pay such party's share of the joint expenses, and to deal generally with, and with power to bind, the co-owners of such party's interests within the scope of the operations embraced in this agreement; however, all such co-owners shall have the right to enter into and execute all contracts or agreements for the disposition of their respective shares of the oil and gas produced from the Contract Area and they shall have the right to receive, separately, payment of the sale proceeds hereof.

**F. Waiver of Right to Partition:**

If permitted by the laws of the state or states in which the property covered hereby is located, each party hereto owning an undivided interest in the Contract Area waives any and all rights it may have to partition and have set aside to it in severalty its undivided interest therein.

**G. Preferential Right to Purchase:**

~~Should any party desire to sell all or any part of its interests under this agreement, or its rights and interests in the Contract Area, it shall promptly give written notice to the other parties, with full information concerning its proposed sale, which shall include the name and address of the prospective purchaser (who must be ready, willing and able to purchase), the purchase price, and all other terms of the offer. The other parties shall then have an optional prior right, for a period of ten (10) days after receipt of the notice, to purchase on the same terms and conditions the interest which the other party proposes to sell; and, if this optional right is exercised, the purchasing parties shall share the purchased interest in the proportions that the interest of each bears to the total interest of all purchasing parties. However, there shall be no preferential right to purchase in those cases where any party wishes to mortgage its interests, or to dispose of its interests by merger, reorganization, consolidation, or sale of all or substantially all of its assets to a subsidiary or parent company or to a subsidiary of a parent company, or to any company in which any one party owns a majority of the stock.~~

**ARTICLE IX.  
INTERNAL REVENUE CODE ELECTION**

This agreement is not intended to create, and shall not be construed to create, a relationship of partnership or an association for profit between or among the parties hereto. Notwithstanding any provisions herein that the rights and liabilities hereunder are several and not joint or collective, or that this agreement and operations hereunder shall not constitute a partnership, if, for Federal income tax purposes, this agreement and the operations hereunder are regarded as a partnership, each party hereby affected elects to be excluded from the application of all of the provisions of Subchapter "K", Chapter 1, Subtitle "A", of the Internal Revenue Code of 1954, as permitted and authorized by Section 701 of the Code and the regulations promulgated thereunder. Operator is authorized and directed to execute on behalf of each party hereby affected such evidence of this election as may be required by the Secretary of the Treasury of the United States or the Federal Internal Revenue Service, including specifically, but not by way of limitation, all of the returns, statements, and the data required by Federal Regulations 1.761. Should there be any requirement that each party hereby affected give further evidence of this election, each such party shall execute such documents and furnish such other evidence as may be required by the Federal Internal Revenue Service or as may be necessary to evidence this election. No

1 such party shall give any notices or take any other action inconsistent with the election made hereby.  
2 If any present or future income tax laws of the state or states in which the Contract Area is located or  
3 any future income tax laws of the United States contain provisions similar to those in Subchapter "K",  
4 Chapter 1, Subtitle "A", of the Internal Revenue Code of 1954, under which an election similar to that  
5 provided by Section 761 of the Code is permitted, each party hereby affected shall make such election as  
6 may be permitted or required by such laws. In making the foregoing election, each such party states that  
7 the income derived by such party from Operations hereunder can be adequately determined without the  
8 computation of partnership taxable income.

9  
10 **ARTICLE X.**  
11 **CLAIMS AND LAWSUITS**

12  
13 Operator may settle any single damage claim or suit arising from operations hereunder if the ex-  
14 penditure does not exceed Three Thousand Five Hundred and no/100----- Dollars  
15 (\$ 3,500.00 ) and if the payment is in complete settlement of such claim or suit. If the amount  
16 required for settlement exceeds the above amount, the parties hereto shall assume and take over the  
17 further handling of the claim or suit, unless such authority is delegated to Operator. All costs and ex-  
18 pense of handling, settling, or otherwise discharging such claim or suit shall be at the joint expense  
19 of the parties. If a claim is made against any party or if any party is sued on account of any matter  
20 arising from operations hereunder over which such individual has no control because of the rights given  
21 Operator by this agreement, the party shall immediately notify Operator, and the claim or suit shall  
22 be treated as any other claim or suit involving operations hereunder.

23  
24 **ARTICLE XI.**  
25 **FORCE MAJEURE**

26  
27 If any party is rendered unable, wholly or in part, by force majeure to carry out its obligations  
28 under this agreement, other than the obligation to make money payments, that party shall give to all  
29 other parties prompt written notice of the force majeure with reasonably full particulars concerning it;  
30 thereupon, the obligations of the party giving the notice, so far as they are affected by the force majeure,  
31 shall be suspended during, but no longer than, the continuance of the force majeure. The affected party  
32 shall use all reasonable diligence to remove the force majeure situation as quickly as practicable.

33  
34 The requirement that any force majeure shall be remedied with all reasonable dispatch shall not  
35 require the settlement of strikes, lockouts, or other labor difficulty by the party involved, contrary to its  
36 wishes; how all such difficulties shall be handled shall be entirely within the discretion of the party  
37 concerned.

38  
39 The term "force majeure", as here employed, shall mean an act of God, strike, lockout, or other  
40 industrial disturbance, act of the public enemy, war, blockade, public riot, lightning, fire, storm, flood,  
41 explosion, governmental action, governmental delay, restraint or inaction, unavailability of equipment,  
42 and any other cause, whether of the kind specifically enumerated above or otherwise, which is not  
43 reasonably within the control of the party claiming suspension.

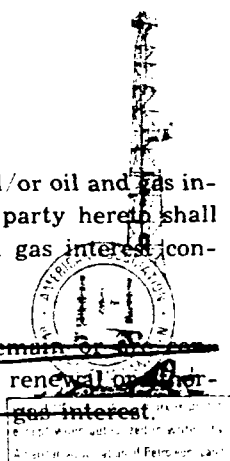
44  
45 **ARTICLE XII.**  
46 **NOTICES**

47  
48 All notices authorized or required between the parties, and required by any of the provisions of  
49 this agreement, unless otherwise specifically provided, shall be given in writing by United States mail  
50 or Western Union telegram, postage or charges prepaid, or by teletype, and addressed to the party to  
51 whom the notice is given at the addresses listed on Exhibit "A". The originating notice given under any  
52 provision hereof shall be deemed given only when received by the party to whom such notice is directed,  
53 and the time for such party to give any notice in response thereto shall run from the date the originat-  
54 ing notice is received. The second or any responsive notice shall be deemed given when deposited in  
55 the United States mail or with the Western Union Telegraph Company, with postage or charges prepaid,  
56 or when sent by teletype. Each party shall have the right to change its address at any time, and from  
57 time to time, by giving written notice hereof to all other parties.

58  
59 **ARTICLE XIII.**  
60 **TERM OF AGREEMENT**

61  
62 This agreement shall remain in full force and effect as to the oil and gas leases and/or oil and gas in-  
63 terests subjected hereto for the period of time selected below; provided, however, no party hereto shall  
64 ever be construed as having any right, title or interest in or to any lease, or oil and gas interest con-  
65 tributed by any other party beyond the term of this agreement.

66  
67  ~~Option No. 1: So long as any of the oil and gas leases subject to this agreement remain or are re-~~  
68 ~~tinued in force as to any part of the Contract Area, whether by production, extension, renewal or ther-~~  
69 ~~wise, and/or so long as oil and/or gas production continues from any lease or oil and gas interest.~~



1  Option No. 2: In the event the well described in Article VI.A., or any subsequent well drilled  
2 under any provision of this agreement, results in production of oil and or gas in paying quantities, this  
3 agreement shall continue in force so long as any such well or wells produce, or are capable of produc-  
4 tion, and for an additional period of 90 days from cessation of all production; provided, however,  
5 if, prior to the expiration of such additional period, one or more of the parties hereto are engaged in  
6 drilling or reworking a well or wells hereunder, this agreement shall continue in force until such op-  
7 erations have been completed and if production results therefrom, this agreement shall continue in  
8 force as provided herein. In the event the well described in Article VI.A., or any subsequent well  
9 drilled hereunder, results in a dry hole, and no other well is producing, or capable of producing oil  
10 and or gas from the Contract Area, this agreement shall terminate unless drilling or reworking opera-  
11 tions are commenced within 90 days from the date of abandonment of said well.

12  
13 It is agreed, however, that the termination of this agreement shall not relieve any party hereto from  
14 any liability which has accrued or attached prior to the date of such termination.

15  
16 **ARTICLE XIV.**  
17 **COMPLIANCE WITH LAWS AND REGULATIONS**

18  
19 **A. Laws, Regulations and Orders:**

20  
21 This agreement shall be subject to the conservation laws of the state in which the committed  
22 acreage is located, to the valid rules, regulations, and orders of any duly constituted regulatory body of  
23 said state; and to all other applicable federal, state, and local laws, ordinances, rules, regulations, and  
24 orders.

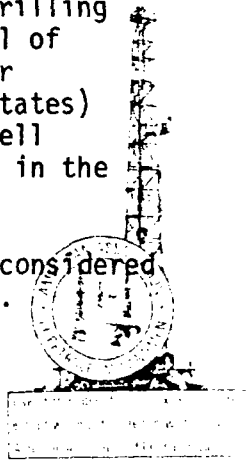
25  
26 **B. Governing Law:**

27  
28 The essential validity of this agreement and all matters pertaining thereto, including, but not lim-  
29 ited to, matters of performance, non-performance, breach, remedies, procedures, rights, duties and in-  
30 terpretation or construction, shall be governed and determined by the law of the state in which the  
31 Contract Area is located. If the Contract Area is in two or more states, the law of the state where most  
32 of the land in the Contract Area is located shall govern.

33  
34 **ARTICLE XV.**  
35 **OTHER PROVISIONS**

36 (A) It is recognized and agreed that Belco Development Corporation, Cities Service  
37 Oil and Gas Corporation, A. G. Hamilton, and Merland, Inc., herein referred to as  
38 FARMORS, are hereby entering into an agreement for the drilling and development  
39 of the S 1/2 NE 1/4 and S 1/2 SE 1/4 of Section 28, T-23-S, R-28-E, N.M.P.M., Eddy  
40 County, New Mexico, whereby FARMORS are farming out their interests in said lands  
41 on the following basis:

- 42  
43 1. Amnex Petroleum, Inc., hereinafter referred to as FARMEE, at its  
44 sole cost, risk and expense, shall commence the initial farmout  
45 well on or before December 31, 1983, and continue drilling thereof  
46 with reasonable diligence and in a workmanlike manner until the  
47 well has been drilled to a depth of 7,200 feet or a depth sufficient  
48 to test the Bone Spring Formation, whichever is the lesser depth  
49 and complete same as a well capable of production or as a dry hole.  
50 Failure to meet any required drilling date under this Farmout shall  
51 result only in termination of all of FARMEE'S farmout rights not  
52 previously earned hereunder. Said well must be completed within  
53 ninety (90) days of commencement.  
54  
55 2. Upon completion of the initial well as a producer of oil and/or gas  
56 in commercial quantities and in consideration for FARMEE having carried  
57 all of the expensed attributable to FARMORS interest in the drilling  
58 and completion of said well, FARMORS will assign to FARMEE all of  
59 FARMORS right, title and interest (including any beneficial or  
60 contractual interest in all oil, gas and mineral leasehold estates)  
61 in the test well and proration unit surrounding the earning well  
62 from the surface to fifty (50) feet below total depth drilled in the  
63 earning well.  
64  
65 3. A proration unit for the purposes of this agreement shall be considered  
66 to contain eighty (80) acres of any part of the contract area.





4. If FARMORS shall become obligated to assign any part of their above described interest under the proration unit attributable to the test well, FARMORS shall reserve unto themselves, their successors and assigns under the well and proration unit surrounding the well an overriding royalty interest of 25% (inclusive of pre-existing overriding royalty interests and royalty burdens), but reserving no less than a minimum one (1) percent overriding royalty. The overriding royalty interest so reserved shall be free and clear of all costs and expenses except applicable taxes on production, and both the overriding royalty interest and the interest conveyed shall be reduced in the proportion that the net mineral acres covered by such assigned interest bears to the total net mineral acres contained within such proration unit.
5. If FARMEE elects to drill an additional well or wells on the farmout lands, such well(s) must be commenced on or before 120 days from the date of drilling rig release from the previous well drilled hereunder. FARMEE shall have the option on such additional well(s) to drill and earn in accordance with the same terms and conditions as those set out above for the initial test well, or to drill instead to a depth of 6000 feet or the stratigraphic equivalent of the top of the Bone Spring formation, whichever is the lesser depth, and earn rights from surface to said depth upon having secured production in commercial quantities.
6. Each FARMOR shall be responsible for furnishing their Geological Requirements and Reporting Instructions for well information to Ammex Petroleum, Inc., at P.O. Box 10507, Midland, Texas, 79702.

(B) If because of encountering impenetrable substances or because of other conditions, making further drilling impracticable, drilling is discontinued in the initial test well as provided for in Article VI or XV hereof before the depth requirement therefor is satisfied, FARMEE shall have the right but not the obligation to drill a substitute well at a location of its choice on the Contract Area. The actual drilling of said substitute well shall be commenced not later than thirty (30) days after cessation of diligent operations in the test well provided herein. Such substitute test well shall for all purposes herein be deemed to be the initial test well and shall be drilled in the same manner and to the same depth specified for the initial test well and shall in all respects earn the same right and interest as applicable for said initial test well.

(C) FARMORS representatives shall be allowed free access to the derrick floor at its sole risk and expense, and to any and all information, geological or otherwise, pertaining to the drilling of the test well and all other wells drilled under the terms of this agreement. Prior to running any logging device, coring or taking any formation test, or other similar type test, FARMEE shall first give FARMORS 24 hours notice (exclusive of Saturdays, Sundays and holidays) to allow its representatives to be present to witness such test. Any notice or test data required hereunder to be given FARMORS shall be furnished as provided in Exhibit "G" hereto, or as otherwise directed in writing by each FARMOR hereunder.

(D) At all times while FARMEE is conducting operations hereunder, it will indemnify, defend and hold FARMORS harmless from and against any and all claims made in connection with its operations on said leases.

(E) In the event FARMEE desires to abandon the well as a dry hole, FARMEE shall so notify FARMORS and FARMORS shall have 24 hours notice (exclusive of Saturdays, Sundays and holidays) to elect to take over the well and attempt a completion. Should FARMORS take over said well, FARMEE will relinquish all rights in and to said well, the materials and equipment used in connection therewith, and the leasehold covering the proration unit free and clear of all liens and encumbrances not presently existing. FARMORS will pay to FARMEE the fair market value of the salvable in-hole equipment, less the estimated cost of salvage. Should FARMORS so elect to take over the well and complete same as a producer of oil and/or gas, FARMEE shall not earn any rights attributable to said well and FARMEE shall convey to FARMORS the well and equipment free and clear of all liens.

(F) Without cost to FARMORS, FARMEE shall secure and shall require its contractors or subcontractors to secure and to thereafter carry insurance in the amount prescribed in Exhibit "D" to the Operating Agreement.

(G) FARMORS do not warrant title to the farmout acreage subject hereto in any manner and shall not be obligated to furnish FARMEE any title opinions to the leases or lands subject hereto. FARMEE agrees to furnish FARMORS with copies of all title opinions, curative material, etc., which the FARMEE obtains on the contract area.

(H) All of the terms, covenants, conditions and provisions hereof shall inure to, be available to and binding upon the parties hereto, their respective heirs, executors, administrators, assigns and successors; however, it is expressly agreed that the FARMEE shall not assign this agreement, or FARMEE'S interest therein or any portion thereof, without notifying FARMORS of the details of such assignment and obtaining FARMORS' express written consent.

(I) Non-Discrimination in the performance on this Agreement, FARMEE agrees to comply fully with the non-discrimination provisions of Section 202 of Executive Order 11246, as amended, which are hereby included in this agreement as Exhibit "F". FARMEE shall also abide by the requirements of Executive Order 11246, Veterans' Employment Provision, which order is incorporated herein by reference.

(J) This agreement is made subject to Cities Service Oil and Gas Corporation's right to purchase production as reserved by it in assignments delivered to Operator pursuant to that certain Agreement dated November 7, 1980, between Cities Service Company and Belco Petroleum Corporation. In addition to the right to purchase production by Cities Service Oil and Gas Corporation, FARMORS reserve the right to purchase their proportionate part of the remaining production.

(K) This agreement shall supersede that certain Operating Agreement dated January 1, 1982, between Belco Petroleum Corporation as operator and Cities Service Oil and Gas Corporation et al as non-operators, but only as to those depths in the acreage in the contract area covered hereby, and for only so long as this agreement remains in force and effect.

ARTICLE XVI.  
MISCELLANEOUS

This agreement shall be binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, legal representatives, successors and assigns.

This instrument may be executed in any number of counterparts, each of which shall be considered an original for all purposes.

IN WITNESS WHEREOF, this agreement shall be effective as of \_\_\_\_\_ day of \_\_\_\_\_,

19\_\_\_\_.

FARMOR  
AND  
OPERATOR

AMMEX PETROLEUM, INC.

BY: *W. A. Johnson*

NON-OPERATORS

A. G. HAMILTON

BELCO DEVELOPMENT CORPORATION

BY: \_\_\_\_\_

BY: *R. A. Grinstead*

R. A. Grinstead, Vice President

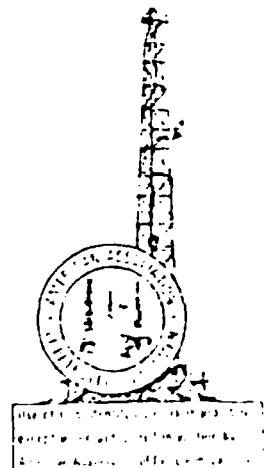
MERLAND, INC.

CITIES SERVICE OIL AND GAS CORPORATION

BY: \_\_\_\_\_

BY: \_\_\_\_\_

Attached to and made a part of that certain Operating Agreement dated September 14, 1983, by and between Ammex Petroleum, Inc. as Operator, and Belco Development Corporation, et al, as Non-Operator.



ARTICLE XVI.  
MISCELLANEOUS

This agreement shall be binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, legal representatives, successors and assigns.

This instrument may be executed in any number of counterparts, each of which shall be considered an original for all purposes.

IN WITNESS WHEREOF, this agreement shall be effective as of \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_.

FARMOR  
AND  
OPERATOR

AMMEX PETROLEUM, INC.

BY: \_\_\_\_\_

NON-OPERATORS

A. G. HAMILTON

BELCO DEVELOPMENT CORPORATION

BY: \_\_\_\_\_

BY: R. A. Grinstead  
R. A. Grinstead, Vice President

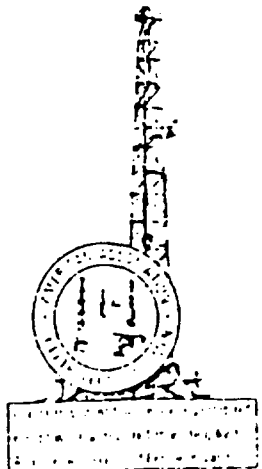
MERLAND, INC.

CITIES SERVICE OIL AND GAS CORPORATION

BY: \_\_\_\_\_

BY: Bryan B. Roberts *DBH*  
Bryan B. Roberts Attorney-in-Fact

Attached to and made a part of that certain Operating Agreement dated September 14, 1983, by and between Ammex Petroleum, Inc., as Operator, and Belco Development Corporation, et al, as Non-Operator.



ARTICLE XVI.  
MISCELLANEOUS

This agreement shall be binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, legal representatives, successors and assigns.

This instrument may be executed in any number of counterparts, each of which shall be considered an original for all purposes.

IN WITNESS WHEREOF, this agreement shall be effective as of \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_.

FARMOR  
AND  
OPERATOR

AMMEX PETROLEUM, INC.

BY: \_\_\_\_\_

NON-OPERATORS

A. G. HAMILTON

BY: \_\_\_\_\_

MERLAND, INC.

BY: \_\_\_\_\_

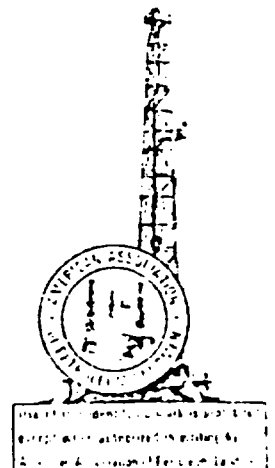
BELCO DEVELOPMENT CORPORATION

BY: \_\_\_\_\_

R. A. Grinstead, Vice President  
CITIES SERVICE OIL AND GAS CORPORATION

BY: \_\_\_\_\_

Attached to and made a part of that certain Operating Agreement dated September 14, 1983, by and between Ammex Petroleum, Inc., as Operator, and Belco Development Corporation, et al, as Non-Operator.



ARTICLE XVI.  
MISCELLANEOUS

This agreement shall be binding upon and shall inure to the benefit of the parties hereto and to their respective heirs, devisees, legal representatives, successors and assigns.

This instrument may be executed in any number of counterparts, each of which shall be considered an original for all purposes.

IN WITNESS WHEREOF, this agreement shall be effective as of \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_.

FARMOR  
AND  
OPERATOR

AMMEX PETROLEUM, INC.

BY: \_\_\_\_\_

NON-OPERATORS

A. G. HAMILTON

BELCO DEVELOPMENT CORPORATION

BY: \_\_\_\_\_

BY: R. A. Grinstead  
R. A. Grinstead, Vice President

MERLAND, INC.

CITIES SERVICE OIL AND GAS CORPORATION

BY: Mary Frances Merfant  
President

BY: \_\_\_\_\_

Attached to and made a part of that certain Operating Agreement dated September 14, 1983, by and between Ammex Petroleum, Inc. as Operator, and Belco Development Corporation, et al, as Non-Operator.

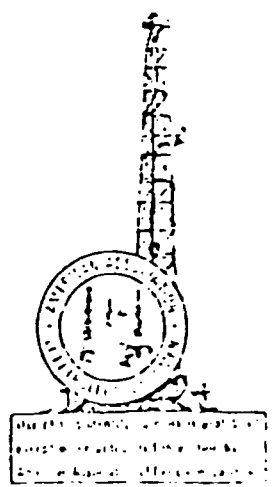


EXHIBIT "A"

Attached to and made a part of that certain Operating Agreement and Farmout Agreement dated September 14, 1983, by and between Ammex Petroleum, Inc., Operator, and Belco Development Corporation, et al, Non-Operator.

I. Lands subject to Operating Agreement:

S 1/2 NE 1/4 and S 1/2 SE 1/4 of Section 28, T-23-S, R-28-E, N.M.P.M. Eddy County, New Mexico

II. Depth Restrictions:

From surface to fifty (50) feet below total depth drilled in each well or the stratigraphic equivalent of the base of the Bone Spring formation, whichever is the lesser depth.

III. Working Interest Participation of the Parties:

	<u>Surface to 5500'</u>	<u>5500' to 50' below TD or the stratigraphic equivalent of the base of the Bone Spring formation</u>
Ammex Petroleum, Inc.	72.2839%	82.9089%
Glen Cope	15.2161%	17.0911%
Pardue Farms (Unleased minerals)	12.5000%	-0-
*Belco Development Corporation	-0-	-0-
*Cities Service Oil and Gas Corp.	-0-	-0-
*A. G. Hamilton	-0-	-0-
*Merland, Inc. (Unleased minerals)	-0-	-0-

\*Belco, Hamilton, Merland, and Cities have agreed to farmout their interest in the contract area to Ammex Petroleum, Inc., on a produce to earn basis and reserve an overriding royalty equal to the difference between 25% and all lease burdens, but reserving no less than a 1% overriding royalty. (See Article XV.A.4)

It is hereby agreed by the parties hereto that Belco Development Corporation, Operator of the Cavalier #1 for which the spacing includes the entire E 1/2 of Section 28, T-23-S, R-28-E, shall not be obligated in any way to maintain production from said well: 1) in order to prevent the expiration of any leases covered by the contract area hereunder, or 2) so that Ammex Petroleum may meet any obligation imposed by this farmout.

The interests being farmed out to Ammex are owned in the following percentages by the FARMORS:

Belco Development Corporation	39.8792%
A. G. Hamilton	6.2500%
Merland, Inc.	3.1250%
Cities Service Oil and Gas Corporation	33.6547%

IV. Addresses of the Working Interest Owners:

Ammex Petroleum, Inc.  
P.O. Box 10507  
Midland, Texas 79702

Cities Service Oil and Gas Corporation  
P.O. Box 1919  
Midland, Texas 79702

Glen Cope  
P.O. Box 1405  
1604 W. Front  
Midland, Texas 79701

A. G. Hamilton  
P.O. Box 1081  
Albuquerque, New Mexico 87103

Belco Development Corporation  
10,000 Old Katy Road, Suite 100  
Houston, Texas 77055

Merland, Inc. (Unleased)  
P.O. Box 548  
Carlsbad, New Mexico 88220



# OIL & GAS LEASE

THIS AGREEMENT made this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_, between \_\_\_\_\_

Merland, Inc.

(Post Office Address)

herein called lessor (whether one or more) and \_\_\_\_\_, lessee:

1. Lessor, in consideration of TEN AND OTHER DOLLARS in hand paid, receipt of which is here acknowledged, and of the royalties herein provided and of the agreements of the lessee herein contained, hereby grants, leases and lets exclusively unto lessee for the purpose of investigating, exploring, prospecting, drilling, and operating for and producing oil and gas, injecting gas, waters, other fluids, and air into subsurface strata, laying pipe lines, storing oil, building tanks, roadways, telephone lines, and other structures and things thereon to produce, save, take care of, treat, process, store and transport said minerals, the

following described land in Eddy County, New Mexico, to-wit:

SE/4 NW/4 SE/4 Section 28, T-23-S, R-28-E, N.M.P.M.

(In all respects Paragraph 3 is amended to indicate one-fourth (1/4) rather than one-eighth (1/8).)

For the purpose of calculating the rental payments hereinafter provided for, said land is estimated to comprise \_\_\_\_\_ acres, whether it actually comprises more or less.

2. Subject to the other provisions herein contained, this lease shall remain in force for a term of ten (10) years from this date (called "primary term"), and as long thereafter as oil or gas, is produced from said land or land with which said land is pooled.

3. The royalties to be paid by lessee are: (a) on oil, and on other liquid hydrocarbons saved at the well, one-eighth of that produced and saved from said land, same to be delivered at the wells or to the credit of lessor in the pipe line to which the wells may be connected; (b) on gas, including casinghead gas and all gaseous substances, produced from said land and sold or used off the premises or in the manufacture of gasoline or other product therefrom, the market value at the mouth of the well of one-eighth of the gas so sold or used, provided that on gas sold at the wells the royalty shall be one-eighth of the amount realized from such sale; (c) and at any time when this lease is not validated by other provisions hereof and there is a gas and/or condensate well on said land, or land pooled therewith, but gas and/or condensate is not being so sold or used and such well is shut in, either before or after production therefrom, then on or before 90 days after said well is shut in, and thereafter at annual intervals, lessee may pay or tender an advance annual shut-in royalty equal to the amount of delay rentals provided for in this lease for the acreage then held under this lease by the party making such payment or tender, and so long as said shut-in royalty is paid or tendered this lease shall not terminate and it will be considered under all clauses hereof that gas is being produced from the leased premises in paying quantities. Each such payment shall be paid or tendered to the party or parties who at the time of such payment would be entitled to receive the royalties which would be paid under this lease if the well were in fact producing, or be paid or tendered to the credit of such party or parties in the depository bank and in the manner hereinafter provided for the payment of rentals.

4. If operations for drilling are not commenced on said land or on land pooled therewith on or before one (1) year from this date, this lease shall terminate

as to both parties, unless on or before one (1) year from this date lessee shall pay or tender to the lessor a rental of \$ \_\_\_\_\_ which shall cover the privilege of deferring commencement of such operations for a period of twelve (12) months. In like manner and upon like payments or tenders, annually, the commencement of said operations may be further deferred for successive periods of twelve (12) months each during the primary term. Payment

or tender may be made to the lessor or to the credit of the lessor in the \_\_\_\_\_ Bank

at \_\_\_\_\_, which bank, or any successor thereof, shall continue to be the agent for the lessor and lessor's heirs and assigns. If such bank (or any successor bank) shall fail, liquidate, or be succeeded by another bank, or for any reason shall fail or refuse to accept rental, lessee shall not be held in default until thirty (30) days after lessor shall deliver to lessee a recordable instrument making provision for another acceptable method of payment or tender, and any depository charge is a liability of the lessor. The payment or tender of rental may be made by check or draft of lessee, mailed or delivered to said bank or lessor, or any lessor if more than one, on or before the rental paying date. Any timely payment or tender of rental or shut-in royalty which is made in a bona fide attempt to make proper payment, but which is erroneous in whole or in part as to parties, amounts, or depositories shall nevertheless be sufficient to prevent termination of this lease in the same manner as though a proper payment had been made; provided, however, lessee shall correct such error within thirty (30) days after lessee has received written notice thereof by certified mail from lessor together with such instruments as are necessary to enable lessee to make proper payment.

5. Lessee is hereby granted the right and power, from time to time, to pool or combine this lease, the land covered by it or any part or horizon thereof with any other land, lease, leases, mineral estates or parts thereof for the production of oil or gas. Units pooled hereunder shall not exceed the standard production unit fixed by law or by the New Mexico Oil Conservation Commission or by other lawful authority for the pool or area in which said land is situated, plus a tolerance of 10%. Lessee shall file written unit designations in the county in which the premises are located and such units may be designated from time to time and either before or after the completion of wells. Drilling operations on or production from any part of any such unit shall be considered for all purposes, except the payment of royalty, as operations conducted upon or production from the land described in this lease. There shall be allocated to the land covered by this lease included in any such unit that portion of the total production of pooled minerals from wells in the unit, after deducting any used in lease or unit operations, which the number of surface acres in the land covered by this lease included in the unit bears to the total number of surface acres in the unit. The production so allocated shall be considered for all purposes, including the payment or delivery of royalty, to be the entire production of pooled minerals from the portion of said land covered hereby and included in said unit in the same manner as though produced from said land under the terms of this lease. Any pooled unit designated by lessee, as provided herein, may be dissolved by lessee by recording an appropriate instrument in the County where the land is situated at any time after the completion of a dry hole or the cessation of production on said unit. Lessee is further granted the right and power to commit this lease as to all or any portion of the above described lands or horizons thereof to any unit agreement for the purpose of conserving the natural resources of any oil or gas pool, field or area covered thereby; provided, such unit agreement contains usual and customary provisions for the allocation of oil and gas produced from the unit area and such unit agreement embraces lands of either the United States or State of New Mexico or both, and the form of unit agreement has been approved by either the United States Geological Survey or Commissioner of Public Lands or both and the New Mexico Oil Conservation Commission, and upon such commitment the provisions of this lease shall be conformed to the unit agreement.

6. If prior to the discovery of oil or gas hereunder, lessee should drill and abandon a dry hole or holes hereunder, or if after discovery of oil or gas the production thereof should cease for any cause, this lease shall not terminate if lessee commences reworking or additional drilling operations within 60 days thereafter and diligently prosecutes the same, or (if it be within the primary term) commences or resumes the payment or tender of rentals or commences operations for drilling or reworking on or before the rental paying date next ensuing after the expiration of three months from date of abandonment of said dry hole or holes or the cessation of production. If at the expiration of the primary term oil or gas is not being produced but lessee is then engaged in operations for drilling or reworking of any well, this lease shall remain in force so long as such operations are diligently prosecuted with no cessation of more than 60 consecutive days. If during the drilling or reworking of any well under this paragraph, lessee loses or junks the hole or well and after diligent efforts in good faith is unable to complete said operations then within 30 days after the abandonment of said operations lessee may commence another well and drill the same with due diligence. If any drilling, additional drilling, or reworking operations hereunder result in production, then this lease shall remain in full force so long thereafter as oil or gas is produced hereunder.

7. Lessee shall have free use of oil, gas and water from said land, except water from lessor's wells and tanks, for all operations hereunder, and the royalty shall be computed after deducting any so used. Lessee shall have the right at any time during or after the expiration of this lease to remove all property and fixtures placed by lessee on said land, including the right to draw and remove all casing. When required by lessor, lessee will bury all pipe lines on cultivated lands below ordinary plow depth, and no well shall be drilled within two hundred feet (200 ft.) of any residence or barn now on said land without lessor's consent. Lessor shall have the privilege, at his risk and expense, of using gas from any gas well on said land for stoves and inside lights in the principal dwelling thereon, out of any surplus gas not needed for operations hereunder.

8. The rights of either party hereunder may be assigned in whole or in part and the provisions hereof shall extend to the heirs, executors, administrators, successors and assigns; but no change or division in the ownership of the land, or in the ownership of or right to receive rentals, royalties or payments, however accomplished shall operate to enlarge the obligations or diminish the rights of lessee; and no such change or division shall be binding upon lessee for any purpose until 30 days after lessee has been furnished by certified mail at lessee's principal place of business with acceptable instruments or certified copies thereof constituting the chain of title from the original lessor. If any such change in ownership occurs through the death of the owner, lessee may pay or tender any rentals, royalties or payments to the credit of the deceased or his estate in the depository bank until such time as lessee has been furnished with evidence satisfactory to lessee as to the persons entitled to such sums. In the event of an assignment of this lease as to a segregated portion of said land, the rentals payable hereunder shall be apportioned as between the several leasehold owners ratably according to the surface area of each, and default in rental payment by one shall not affect the rights of other leasehold owners hereunder. An assignment of this lease, in whole or in part, shall, to the extent of such assignment, relieve and discharge lessee of any obligations hereunder, and, if lessee or assignee of part or parts hereof shall fail or make default in the payment of the proportionate part of the rentals due from such lessee or assignee or fail to comply with any other provision of the lease, such default shall not affect this lease in so far as it covers a part of said lands upon which lessee or any assignee thereof shall so comply or make such payments. Rentals as used in this paragraph shall also include shut-in royalty.

9. Should lessee be prevented from complying with any express or implied covenant of this lease, or from conducting drilling or reworking operations hereunder, or from producing oil or gas hereunder by reason of scarcity or inability to obtain or use equipment or material, or by operation of force majeure, or by any Federal or state law or any order, rule or regulation of governmental authority, then while so prevented, lessee's duty shall be suspended, and lessee shall not be liable for failure to comply therewith; and this lease shall be extended while and so long as lessee is prevented by any such cause from conducting drilling or reworking operations on or from producing oil or gas hereunder; and the time while lessee is so prevented shall not be counted against lessee, anything in this lease to the contrary notwithstanding.

10. Lessor hereby warrants and agrees the title to said land, and agrees that lessee, at its option, may discharge any tax, mortgage, or other lien upon said land, and in the event lessee does so, it shall be subrogated to such lien with the right to enforce same and apply rentals and royalties accruing hereunder toward satisfying same. Without impairment of lessee's rights under the warranty, if this lease covers a less interest in the oil or gas in all or any part of said land than the entire and undivided fee simple estate (whether lessor's interest is herein specified or not) then the royalties, shut-in royalty, rental, and other payments, if any, accruing from any part as to which this lease covers less than such full interest, shall be paid only in the proportion which the interest therein, if any, covered by this lease, bears to the whole and undivided fee simple estate therein. Should any one or more of the parties named above as lessors fail to execute this lease, it shall nevertheless be binding upon the party or parties executing the same.

11. Lessee, its successors, heirs and assigns, shall have the right at any time to surrender this lease, in whole or in part, to lessor or his heirs, successors, and assigns by delivering or mailing a release thereof to the lessor, or by placing a release thereof of record in the county in which said land is situated; thereupon lessee shall be relieved from all obligations, expressed or implied, of this agreement as to acreage so surrendered, and thereafter the rentals and shut-in royalty payable hereunder shall be reduced in the proportion that the acreage covered hereby is reduced by said release or releases.

Executed the day and year first above written.

## Exhibit "B"

Attached to and made a part of that certain Operating Agreement and Farmout Agreement dated 9-14-83, by and between Ammex Petroleum, Inc., Operator, and Belco Development Corporation et al Non-Operator

**EXHIBIT " C "**

Attached to and made a part of Operating Agreement dated  
September 14, 1983 by and between Ammex Petroleum,  
Inc., as Operator, and Belco Development Corpor-  
ation, et al, as Non-Operators.

**ACCOUNTING PROCEDURE  
JOINT OPERATIONS**

**I. GENERAL PROVISIONS**

**1. Definitions**

"Joint Property" shall mean the real and personal property subject to the agreement to which this Accounting Procedure is attached.

"Joint Operations" shall mean all operations necessary or proper for the development, operation, protection and maintenance of the Joint Property.

"Joint Account" shall mean the account showing the charges paid and credits received in the conduct of the Joint Operations and which are to be shared by the Parties.

"Operator" shall mean the party designated to conduct the Joint Operations.

"Non-Operators" shall mean the parties to this agreement other than the Operator.

"Parties" shall mean Operator and Non-Operators.

"First Level Supervisors" shall mean those employees whose primary function in Joint Operations is the direct supervision of other employees and/or contract labor directly employed on the Joint Property in a field operating capacity.

"Technical Employees" shall mean those employees having special and specific engineering, geological or other professional skills, and whose primary function in Joint Operations is the handling of specific operating conditions and problems for the benefit of the Joint Property.

"Personal Expenses" shall mean travel and other reasonable reimbursable expenses of Operator's employees.

"Material" shall mean personal property, equipment or supplies acquired or held for use on the Joint Property.

"Controllable Material" shall mean Material which at the time is so classified in the Material Classification Manual as most recently recommended by the Council of Petroleum Accountants Societies of North America.

**2. Statement and Billings**

Operator shall bill Non-Operators on or before the last day of each month for their proportionate share of the Joint Account for the preceding month. Such bills will be accompanied by statements which identify the authority for expenditure, lease or facility, and all charges and credits, summarized by appropriate classifications of investment and expense except that items of Controllable Material and unusual charges and credits shall be separately identified and fully described in detail.

**3. Advances and Payments by Non-Operators**

Unless otherwise provided for in the agreement, the Operator may require the Non-Operators to advance their share of estimated cash outlay for the succeeding month's operation. Operator shall adjust each monthly billing to reflect advances received from the Non-Operators.

Each Non-Operator shall pay its proportion of all bills within fifteen (15) days after receipt. If payment is not made within such time, the unpaid balance shall bear interest monthly at the rate of ~~twelve~~ <sup>two</sup> percent (~~12%~~ <sup>over prime</sup>) per annum or the maximum contract rate permitted by the applicable usury laws in the state in which the Joint Property is located, whichever is the lesser, plus attorney's fees, court costs, and other costs in connection with the collection of unpaid amounts. Prime will be as established by Morgan Guaranty Bank & Trust of New York City, N.Y.

**4. Adjustments**

Payment of any such bills shall not prejudice the right of any Non-Operator to protest or question the correctness thereof; provided, however, all bills and statements rendered to Non-Operators by Operator during any calendar year shall conclusively be presumed to be true and correct after twenty-four (24) months following the end of any such calendar year, unless within the said twenty-four (24) month period a Non-Operator takes written exception thereto and makes claim on Operator for adjustment. No adjustment favorable to Operator shall be made unless it is made within the same prescribed period. The provisions of this paragraph shall not prevent adjustments resulting from a physical inventory of Controllable Material as provided for in Section V.

**5. Audits**

A. Non-Operator, upon notice in writing to Operator and all other Non-Operators, shall have the right to audit Operator's accounts and records relating to the Joint Account for any calendar year within the twenty-four (24) month period following the end of such calendar year; provided, however, the making of an audit shall not extend the time for the taking of written exception to and the adjustments of accounts as provided for in Paragraph 4 of this Section I. Where there are two or more Non-Operators, the Non-Operators shall make every reasonable effort to conduct joint or simultaneous audits in a manner which will result in a minimum of inconvenience to the Operator. Operator shall bear no portion of the Non-Operators' audit cost incurred under this paragraph unless agreed to by the Operator.

**6. Approval by Non-Operators**

Where an approval or other agreement of the Parties or Non-Operators is expressly required under other sections of this Accounting Procedure and if the agreement to which this Accounting Procedure is attached contains no contrary provisions in regard thereto, Operator shall notify all Non-Operators of the Operator's proposal, and the agreement or approval of a majority in interest of the Non-Operators shall be controlling on all Non-Operators.

## II. DIRECT CHARGES

Operator shall charge the Joint Account with the following items:

### 1. Rentals and Royalties

Lease rentals and royalties paid by Operator for the Joint Operations.

### 2. Labor

- A. (1) Salaries and wages of Operator's field employees directly employed on the Joint Property in the conduct of Joint Operations.
- (2) Salaries of First Level Supervisors in the field.
- (3) Salaries and wages of Technical Employees directly employed on the Joint Property if such charges are excluded from the Overhead rates.
- B. Operator's cost of holiday, vacation, sickness and disability benefits and other customary allowances paid to employees whose salaries and wages are chargeable to the Joint Account under Paragraph 2A of this Section II. Such costs under this Paragraph 2B may be charged on a "when and as paid basis" or by "percentage assessment" on the amount of salaries and wages chargeable to the Joint Account under Paragraph 2A of this Section II. If percentage assessment is used, the rate shall be based on the Operator's cost experience.
- C. Expenditures or contributions made pursuant to assessments imposed by governmental authority which are applicable to Operator's costs chargeable to the Joint Account under Paragraphs 2A and 2B of this Section II.
- D. Personal Expenses of those employees whose salaries and wages are chargeable to the Joint Account under Paragraph 2A of this Section II.

### 3. Employee Benefits

Operator's current costs of established plans for employees' group life insurance, hospitalization, pension, retirement, stock purchase, thrift, bonus, and other benefit plans of a like nature, applicable to Operator's labor cost chargeable to the Joint Account under Paragraphs 2A and 2B of this Section II shall be Operator's actual cost not to exceed twenty-three (23%) per cent, or the percent most recently recommended by the Council of Petroleum Accountant Societies of America.

### 4. Material

Material purchased or furnished by Operator for use on the Joint Property as provided under Section IV. Only such Material shall be purchased for or transferred to the Joint Property as may be required for immediate use and is reasonably practical and consistent with efficient and economical operations. The accumulation of surplus stocks shall be avoided.

### 5. Transportation

Transportation of employees and Material necessary for the Joint Operations but subject to the following limitations:

- A. If Material is moved to the Joint Property from the Operator's warehouse or other properties, no charge shall be made to the Joint Account for a distance greater than the distance from the nearest reliable supply store, recognized barge terminal, or railway receiving point where like material is normally available, unless agreed to by the Parties.
- B. If surplus Material is moved to Operator's warehouse or other storage point, no charge shall be made to the Joint Account for a distance greater than the distance to the nearest reliable supply store, recognized barge terminal, or railway receiving point unless agreed to by the Parties. No charge shall be made to the Joint Account for moving Material to other properties belonging to Operator, unless agreed to by the Parties.
- C. In the application of Subparagraphs A and B above, there shall be no equalization of actual gross trucking cost of \$200 or less excluding accessorial charges.

### 6. Services

The cost of contract services, equipment and utilities provided by outside sources, except services excluded by Paragraph 9 of Section II and Paragraph 1. ii of Section III. The cost of professional consultant services and contract services of technical personnel directly engaged on the Joint Property if such charges are excluded from the Overhead rates. The cost of professional consultant services or contract services of technical personnel not directly engaged on the Joint Property shall not be charged to the Joint Account unless previously agreed to by the Parties.

### 7. Equipment and Facilities Furnished by Operator

- A. Operator shall charge the Joint Account for use of Operator owned equipment and facilities at rates commensurate with costs of ownership and operation. Such rates shall include costs of maintenance, repairs, other operating expense, insurance, taxes, depreciation, and interest on investment not to exceed eight per cent (8%) per annum. Such rates shall not exceed average commercial rates currently prevailing in the immediate area of the Joint Property.
- B. In lieu of charges in Paragraph 7A above, Operator may elect to use average commercial rates prevailing in the immediate area of the Joint Property less 20%. For automotive equipment, Operator may elect to use rates published by the Petroleum Motor Transport Association.

### 8. Damages and Losses to Joint Property

All costs or expenses necessary for the repair or replacement of Joint Property made necessary because of damages or losses incurred by fire, flood, storm, theft, accident, or other cause, except those resulting from Operator's gross negligence or willful misconduct. Operator shall furnish Non-Operator written notice of damages or losses incurred as soon as practicable after a report thereof has been received by Operator.

### 9. Legal Expense

Expense of handling, investigating and settling litigation or claims, discharging of liens, payment of judgments and amounts paid for settlement of claims incurred in or resulting from operations under the agreement or necessary to protect or recover the Joint Property, except that no charge for services of Operator's legal staff or fees or expense of outside attorneys shall be made unless previously agreed to by the Parties. All other legal expense is considered to be covered by the overhead provisions of Section III unless otherwise agreed to by the Parties, except as provided in Section I, Paragraph 3.

**10. Taxes**

All taxes of every kind and nature assessed or levied upon or in connection with the Joint Property, the operation thereof, or the production therefrom, and which taxes have been paid by the Operator for the benefit of the Parties.

**11. Insurance**

Net premiums paid for insurance required to be carried for the Joint Operations for the protection of the Parties. In the event Joint Operations are conducted in a state in which Operator may act as self-insurer for Workmen's Compensation and/or Employers Liability under the respective state's laws, Operator may, at its election, include the risk under its self-insurance program and in that event, Operator shall include a charge at Operator's cost not to exceed manual rates.

**12. Other Expenditures**

Any other expenditure not covered or dealt with in the foregoing provisions of this Section II, or in Section III, and which is incurred by the Operator in the necessary and proper conduct of the Joint Operations.

**III. OVERHEAD****1. Overhead - Drilling and Producing Operations**

i. As compensation for administrative, supervision, office services and warehousing costs, Operator shall charge drilling and producing operations on either:

- ( X ) Fixed Rate Basis, Paragraph 1A, or  
 ( ) Percentage Basis, Paragraph 1B.

Unless otherwise agreed to by the Parties, such charge shall be in lieu of costs and expenses of all offices and salaries or wages plus applicable burdens and expenses of all personnel, except those directly chargeable under Paragraph 2A, Section II. The cost and expense of services from outside sources in connection with matters of taxation, traffic, accounting or matters before or involving governmental agencies shall be considered as included in the Overhead rates provided for in the above selected Paragraph of this Section III unless such cost and expense are agreed to by the Parties as a direct charge to the Joint Account.

ii. The salaries, wages and Personal Expenses of Technical Employees and/or the cost of professional consultant services and contract services of technical personnel directly employed on the Joint Property shall ( ) shall not ( X ) be covered by the Overhead rates.

**A. Overhead - Fixed Rate Basis**

(1) Operator shall charge the Joint Account at the following rates per well per month:

Drilling Well Rate \$ 3,000.00  
 Producing Well Rate \$ 300.00

(2) Application of Overhead - Fixed Rate Basis shall be as follows:

**(a) Drilling Well Rate**

- [1] Charges for onshore drilling wells shall begin on the date the well is spudded and terminate on the date the drilling or completion rig is released, whichever is later, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days.
- [2] Charges for offshore drilling wells shall begin on the date when drilling or completion equipment arrives on location and terminate on the date the drilling or completion equipment moves off location or rig is released, whichever occurs first, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days.
- [3] Charges for wells undergoing any type of workover or recompletion for a period of five (5) consecutive days or more shall be made at the drilling well rate. Such charges shall be applied for the period from date workover operations, with rig, commence through date of rig release, except that no charge shall be made during suspension of operations for fifteen (15) or more consecutive days.

**(b) Producing Well Rates**

- [1] An active well either produced or injected into for any portion of the month shall be considered as a one-well charge for the entire month.
- [2] Each active completion in a multi-completed well in which production is not commingled down hole shall be considered as a one-well charge providing each completion is considered a separate well by the governing regulatory authority.
- [3] An inactive gas well shut in because of overproduction or failure of purchaser to take the production shall be considered as a one-well charge providing the gas well is directly connected to a permanent sales outlet.
- [4] A one-well charge may be made for the month in which plugging and abandonment operations are completed on any well.
- [5] All other inactive wells (including but not limited to inactive wells covered by unit allowable, lease allowable, transferred allowable, etc.) shall not qualify for an overhead charge.

(3) The well rates shall be adjusted as of the first day of April each year following the effective date of the agreement to which this Accounting Procedure is attached. The adjustment shall be computed by multiplying the rate currently in use by the percentage increase or decrease in the average weekly earnings of Crude Petroleum and Gas Production Workers for the last calendar year compared to the calendar year preceding as shown by the index of average weekly earnings of Crude Petroleum and Gas Fields Production Workers as published by the United States Department of Labor, Bureau of Labor Statistics, or the equivalent Canadian index as published by Statistics Canada, as applicable. The adjusted rates shall be the rates currently in use, plus or minus the computed adjustment.

**B. Overhead - Percentage Basis**

(1) Operator shall charge the Joint Account at the following rates:

**(a) Development**

\_\_\_\_\_ Percent ( %) of the cost of Development of the Joint Property exclusive of costs provided under Paragraph 9 of Section II and all salvage credits.

**(b) Operating**

\_\_\_\_\_ Percent ( %) of the cost of Operating the Joint Property exclusive of costs provided under Paragraphs 1 and 9 of Section II, all salvage credits, the value of injected substances purchased for secondary recovery and all taxes and assessments which are levied, assessed and paid upon the mineral interest in and to the Joint Property.

(2) Application of Overhead - Percentage Basis shall be as follows:

For the purpose of determining charges on a percentage basis under Paragraph 1B of this Section III, development shall include all costs in connection with drilling, re-drilling, deepening or any remedial operations on any or all wells involving the use of drilling crew and equipment; also, preliminary expenditures necessary in preparation for drilling and expenditures incurred in abandoning when the well is not completed as a producer, and original cost of construction or installation of fixed assets, the expansion of fixed assets and any other project clearly discernible as a fixed asset, except Major Construction as defined in Paragraph 2 of this Section III. All other costs shall be considered as Operating.

**2. Overhead - Major Construction**

To compensate Operator for overhead costs incurred in the construction and installation of fixed assets, the expansion of fixed assets, and any other project clearly discernible as a fixed asset required for the development and operation of the Joint Property, Operator shall either negotiate a rate prior to the beginning of construction, or shall charge the Joint Account for Overhead based on the following rates for any Major Construction project in excess of \$ TO BE NEGOTIATED :

- A. \_\_\_\_\_ % of total costs if such costs are more than \$ \_\_\_\_\_ but less than \$ \_\_\_\_\_ ; plus  
 B. \_\_\_\_\_ % of total costs in excess of \$ \_\_\_\_\_ but less than \$1,000,000; plus  
 C. \_\_\_\_\_ % of total costs in excess of \$1,000,000.

Total cost shall mean the gross cost of any one project. For the purpose of this paragraph, the component parts of a single project shall not be treated separately and the cost of drilling and workover wells shall be excluded.

**3. Amendment of Rates**

The Overhead rates provided for in this Section III may be amended from time to time only by mutual agreement between the Parties hereto if, in practice, the rates are found to be insufficient or excessive.

**IV. PRICING OF JOINT ACCOUNT MATERIAL PURCHASES, TRANSFERS AND DISPOSITIONS**

Operator is responsible for Joint Account Material and shall make proper and timely charges and credits for all material movements affecting the Joint Property. Operator shall provide all Material for use on the Joint Property; however, at Operator's option, such Material may be supplied by the Non-Operator. Operator shall make timely disposition of idle and/or surplus Material, such disposal being made either through sale to Operator or Non-Operator, division in kind, or sale to outsiders. Operator may purchase, but shall be under no obligation to purchase, interest of Non-Operators in surplus condition A or B Material. The disposal of surplus Controllable Material not purchased by the Operator shall be agreed to by the Parties.

**1. Purchases**

Material purchased shall be charged at the price paid by Operator after deduction of all discounts received. In case of Material found to be defective or returned to vendor for any other reason, credit shall be passed to the Joint Account when adjustment has been received by the Operator.

**2. Transfers and Dispositions**

Material furnished to the Joint Property and Material transferred from the Joint Property or disposed of by the Operator, unless otherwise agreed to by the Parties, shall be priced on the following bases exclusive of cash discounts:

**A. New Material (Condition A)**

- (1) Tubular goods, except line pipe, shall be priced at the current new price in effect on date of movement on a maximum carload or barge load weight basis, regardless of quantity transferred, equalized to the lowest published price f.o.b. railway receiving point or recognized barge terminal nearest the Joint Property where such Material is normally available.
- (2) Line Pipe
  - (a) Movement of less than 30,000 pounds shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store nearest the Joint Property where such Material is normally available.
  - (b) Movement of 30,000 pounds or more shall be priced under provisions of tubular goods pricing in Paragraph 2A (1) of this Section IV.
- (3) Other Material shall be priced at the current new price, in effect at date of movement, as listed by a reliable supply store or f.o.b. railway receiving point nearest the Joint Property where such Material is normally available.

**B. Good Used Material (Condition B)**

Material in sound and serviceable condition and suitable for reuse without reconditioning:

- (1) Material moved to the Joint Property
  - (a) At seventy-five percent (75%) of current new price, as determined by Paragraph 2A of this Section IV.
- (2) Material moved from the Joint Property
  - (a) At seventy-five percent (75%) of current new price, as determined by Paragraph 2A of this Section IV, if Material was originally charged to the Joint Account as new Material, or

- (b) at sixty-five percent (65%) of current new price, as determined by Paragraph 2A of this Section IV, if Material was originally charged to the Joint Account as good used Material at seventy-five percent (75%) of current new price.

The cost of reconditioning, if any, shall be absorbed by the transferring property.

**C. Other Used Material (Condition C and D)**

**(1) Condition C**

Material which is not in sound and serviceable condition and not suitable for its original function until after reconditioning shall be priced at fifty percent (50%) of current new price as determined by Paragraph 2A of this Section IV. The cost of reconditioning shall be charged to the receiving property, provided Condition C value plus cost of reconditioning does not exceed Condition B value.

**(2) Condition D**

All other Material, including junk, shall be priced at a value commensurate with its use or at prevailing prices. Material no longer suitable for its original purpose but usable for some other purpose, shall be priced on a basis comparable with that of items normally used for such other purpose. Operator may dispose of Condition D Material under procedures normally utilized by the Operator without prior approval of Non-Operators.

**D. Obsolete Material**

Material which is serviceable and usable for its original function but condition and/or value of such Material is not equivalent to that which would justify a price as provided above may be specially priced as agreed to by the Parties. Such price should result in the Joint Account being charged with the value of the service rendered by such Material.

**E. Pricing Conditions**

- (1) Loading and unloading costs may be charged to the Joint Account at the rate of fifteen cents (15¢) per hundred weight on all tubular goods movements, in lieu of loading and unloading costs sustained, when actual hauling cost of such tubular goods are equalized under provisions of Paragraph 5 of Section II.
- (2) Material involving erection costs shall be charged at applicable percentage of the current knocked-down price of new Material.

**3. Premium Prices**

Whenever Material is not readily obtainable at published or listed prices because of national emergencies, strikes or other unusual causes over which the Operator has no control, the Operator may charge the Joint Account for the required Material at the Operator's actual cost incurred in providing such Material, in making it suitable for use, and in moving it to the Joint Property; provided notice in writing is furnished to Non-Operators of the proposed charge prior to billing Non-Operators for such Material. Each Non-Operator shall have the right, by so electing and notifying Operator within ten days after receiving notice from Operator, to furnish in kind all or part of his share of such Material suitable for use and acceptable to Operator.

**4. Warranty of Material Furnished by Operator**

Operator does not warrant the Material furnished. In case of defective Material, credit shall not be passed to the Joint Account until adjustment has been received by Operator from the manufacturers or their agents.

**V. INVENTORIES**

The Operator shall maintain detailed records of Controllable Material.

**1. Periodic Inventories, Notice and Representation**

At reasonable intervals, Inventories shall be taken by Operator of the Joint Account Controllable Material. Written notice of intention to take inventory shall be given by Operator at least thirty (30) days before any inventory is to begin so that Non-Operators may be represented when any inventory is taken. Failure of Non-Operators to be represented at an inventory shall bind Non-Operators to accept the inventory taken by Operator.

**2. Reconciliation and Adjustment of Inventories**

Reconciliation of a physical inventory with the Joint Account shall be made, and a list of overages and shortages shall be furnished to the Non-Operators within six months following the taking of the inventory. Inventory adjustments shall be made by Operator with the Joint Account for overages and shortages, but Operator shall be held accountable only for shortages due to lack of reasonable diligence.

**3. Special Inventories**

Special Inventories may be taken whenever there is any sale or change of interest in the Joint Property. It shall be the duty of the party selling to notify all other Parties as quickly as possible after the transfer of interest takes place. In such cases, both the seller and the purchaser shall be governed by such inventory.

**4. Expense of Conducting Periodic Inventories**

The expense of conducting periodic Inventories shall not be charged to the Joint Account unless agreed to by the Parties.

attached to and made a part of that certain Operating Agreement and Farmout Agreement dated 9-14-83 by and between Ammex Petroleum, Inc., Operator and Belco Development Corp., et al, Non-Operator

EXHIBIT "D"  
INSURANCE

Operator will carry, or cause to be carried, at the joint expense, that is, on a pro rata basis, of the parties in interest in the Unit Area, the following insurance covering all operations in the Unit Area:

- (a) Workmen's Compensation Insurance, including Employer's Liability, in accordance with the laws of the State where operations are being conducted.
- (b) Comprehensive General Public Liability with bodily injury limits of \$100,000.00 for any one person and \$300,000.00 for any one accident, and property damage limits of \$100,000.00 for any one accident and \$300,000.00 aggregate;
- (c) Automobile Public Liability with bodily injury limits of \$100,000.00 for any one person and \$300,000.00 for any one accident; and property damage limits of \$100,000.00 for each accident; said insurance to cover "owned", "not owned" and "hired" automobiles.

in connection with which it is understood that Operator shall have no obligation to carry any insurance, other than that afore-recited, on operations in the Unit Area unless requested in writing to do so by all of the parties in interest in the leases covering such area. It is further understood that in the event Operator cannot for any reason procure the afore-recited insurance covering operations in the Unit Area, then it will have no liability and/or responsibility for failure to carry such insurance provided it promptly notifies the parties in interest in such area of its inability to so procure such insurance coverage.

If Operator carries blanket insurance coverage on item (b) above, it shall charge the joint account a flat rate of \$500 per annum for such coverage. Such flat rate charge shall be reviewed annually and adjustments made to reflect then current insurance rates for such coverage.

Attached to and made a part of that certain Operating Agreement and Farmout Agreement dated 9-14-83 by and between Ammex Petroleum, Inc., Operator, and Belco Development Corp., et al, Non-Operator

EXHIBIT "F"

NONDISCRIMINATION CLAUSE

Ammex Petroleum, Inc., hereinafter referred to as "Operator", is a "contractor" within the meaning of Executive Order No. 11246 dealing with nondiscrimination and equal employment opportunity.

Ammex Petroleum, Inc., hereinafter called "contractor" in this Exhibit, agrees, unless exempt therefrom, to comply with all provisions of Executive Order 11246, which are incorporated herein by reference, and if contractor has more than 50 employees, contractor must file Standard Form 100 (EEO-1) and develop a written "Affirmative Action Compliance Program" for each of its establishments according to the Rules and Regulations published by the United States Department of Labor in 41 C.F.R., Chapter 60. Further, contractor hereby certifies that it does not now and will not maintain any facilities provided for its employees in a segregated manner or permit its employees to perform their services at any location under its control where segregated facilities are maintained, as such segregated facilities are defined in Title 41, Chapter 101-1.8, Code of Federal Regulations, revised as of 1/1/69, unless exempt therefrom. Contractor further warrants that no other law, regulation or ordinance of the United States, or any state, or any governmental authority or agency has been violated in the manufacture, procurement or sale of any goods furnished, work performed or service rendered pursuant to this contract.

Unless exempt by rules, regulations or orders of the United States Secretary of Labor, issued pursuant to Section 204 of the Executive Order 11246 dated September 24, 1965, during the performance of this contract, the contractor agrees as follows:

"(1) The contractor will not discriminate against any employee or applicant for employment because of race, color, religion, sex or national origin. The contractor will take affirmative action to ensure that applicants are employed and that employees are treated during employment, with regard to their race, color, religion, sex or national origin. Such action shall include, but not be limited to the following: employment, upgrading, demotion or transfer, recruitment or recruitment advertising; layoff or termination; rates of pay or other forms of compensation; and selection for training, including apprenticeship. The contractor agrees to post in conspicuous places, available to employees and applicants for employment, notices to be provided by the contracting officer setting forth the provisions of this nondiscrimination clause.

"(2) The contractor will, in all solicitations or advertisements for employees placed by or on behalf of the contractor, state that all qualified applicants will receive consideration for employment without regard to race, color, religion, sex or national origin.

"(3) The contractor will send to each labor union or representative of workers with which he has a collective bargaining agreement or other contract or understanding, a notice to be provided by the agency contracting officer, advising the labor union or workers' representative of the contractor's commitments under Section 202 of Executive Order 11246 of September 24, 1965, and shall post copies of the notice in conspicuous places available to employees and applicants for employment.



"(4) The contractor will comply with all provisions of Executive Order 11246 of September 24, 1965, and of the rules, regulations and relevant orders of the Secretary of Labor.

"(5) The contractor will furnish all information and reports required by Executive Order 11246 of September 24, 1965, and by the rules, regulations and orders of the Secretary of Labor, or pursuant thereto, and will permit access to his books, records and accounts by the contracting agency and the Secretary of Labor for purposes of investigation to ascertain compliance with such rules, regulations and orders.

"(6) In the event of the contractor's noncompliance with the nondiscrimination clauses of this contract or with any of such rules, regulations or orders, this contract may be cancelled, terminated or suspended in whole or in part and the contractor may be declared ineligible for further Government contracts in accordance with procedures authorized in Executive Order 11246 of September 24, 1965, and such other sanctions may be imposed and remedies invoked as provided in Executive Order 11246 of September 24, 1965, or by rule, regulation or order of the Secretary of Labor, or as otherwise provided by law.

"(7) The contractor will include the provisions of paragraphs (1) through (7) in every subcontract or purchase order unless exempted by rules, regulations or orders of the Secretary of Labor issued pursuant to Section 204 of Executive Order 11246 of September 24, 1965, so that such provisions will be binding upon each subcontractor or vendor. The contractor will take such action with respect to any subcontract or purchase order as the contracting agency may direct as a means of enforcing such provisions including sanctions for noncompliance; provided, however, that in the event the contractor becomes involved in, or is threatened with, litigation with a subcontractor or vendor as a result of such direction by the contracting agency, the contractor may request the United States to enter into such litigation to protect the interests of the United States."

BE J DEVELOPMENT CORPORATION  
REPORTS AND NOTIFICATIONS

OPERATOR: Annex Petroleum, Incorporated

WELL NAME: \_\_\_\_\_

LOCATION: \_\_\_\_\_

1. One daily drilling and/or operations report, including the staking of the location, moving in of materials, rigging up of drilling equipment and spudding operations by telephone to 915-683-6366 or telecopy to 915-683-6588, in Midland, Texas, attention: Ada B. Johnson.
2. On copy of each Texas Railroad Commission or N.M.O.C.C. form submitted is to be mailed to Donald L. Peters, Belco Development Corporation, 411 Petroleum Building, Midland, Texas 79701.
3. On drillstem testing, coring and logging, notify one of the following, in the order listed below, in due time for a Belco representative to witness the operations (office phone: 915-683-6366):
  1. Emory Parrott Home Phone (915) 682-0718
  2. Cina Poyer Home Phone (915) 694-2219
  3. Bill Hartzoge Home Phone (915) 694-6417
4. A separate set of samples is not necessary, if a set is available at the drillsite during drilling operations and a set is delivered to Midland Sample Cut Library.
5. One copy of the mudlogger's report will be mailed daily and two (2) copies of the final log will be mailed to Emory Parrott, Belco Development Corporation, 411 Petroleum Building, Midland, Texas 79701.
6. You agree to run the following logs to the bottom of the hole:

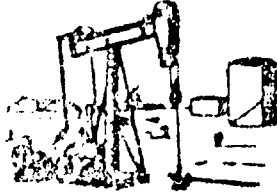
Gamma Ray-Compensated Density-Neutron and an Induction or Laterolog or their commercial equivalents.

You will distribute copies of the above logs plus any additional logs, all reports, analyses and surveys that you run to the following:

	<u>FIELD</u>	<u>FINAL</u>
Belco Development Corporation 411 Petroleum Building Midland, Texas 79701 Attn: <u>Emory Parrott</u>	<u>2</u>	<u>3</u>

7. In the event production is encountered in the initial test well or subsequent well as may be required, weekly production data for the first ninety (90) days following completion will be mailed to Belco Development Corporation, 411 Petroleum Building, Midland, Texas 79701, Attn: Emory Parrott.

Ray Westall



September 10, 1984

BEFORE EXAMINATION OIL CONSERVATION DIVISION <i>Westall</i> BY THE DIVISION 2 CASE NO. <i>8377</i>
---

Re: Oil Conservation Division  
Order No. R-7567  
S/2 NE/4 and S/2 SE/4 Section 28  
T-23-S, R-28-E, N.M.P.M.  
Eddy County, New Mexico  
Pecos Bend Prospect #7466

Dear Miss Cope:

Attached please find a copy of the OCD ammendment to the August 31, 1984  
Order to force pool you interest in this prospect. Also enclosed is  
a copy of our AFE for the drilling of a well on this prospect.

Yours truly,

*Ray Westall*

Ray Westall

Enclosures

PS Form 3811, Jan. 1979

SENDER: Complete items 1, 2, and 3. Add your address in the "RETURN TO" space on reverse.

1. The following service is requested (check one.)  
 Show to whom and date delivered.....60  
 Show to whom, date and address of delivery.....  
 RESTRICTED DELIVERY  
 Show to whom and date delivered.....  
 RESTRICTED DELIVERY.  
 Show to whom, date, and address of delivery \$

(CONSULT POSTMASTER FOR FEES)

2. ARTICLE ADDRESSED TO:  
 Christy Lee Cope  
 8401 Skillman 2069  
 Dallas TX 75231

3. ARTICLE DESCRIPTION:  
 REGISTERED NO. CERTIFIED NO. INSURED NO.  
 P452217054

(Always obtain signature of addressee or agent)

I have received the article described above.  
 SIGNATURE  Addressee  Authorized agent  
 Christy Cope  
 DATE OF DELIVERY POSTMARK  
 13 SEP 1984

5. ADDRESS (Complete only if requested)

6. UNABLE TO DELIVER BECAUSE: CLERK'S INITIALS

★ UPO : 1979-900-459

RETURN RECEIPT, REGISTERED, INSURED AND CERTIFIED MAIL

PS Form 3811, Jan. 1979

SENDER: Complete items 1, 2, and 3. Add your address in the "RETURN TO" space on reverse.

1. The following service is requested (check one.)  
 Show to whom and date delivered.....60  
 Show to whom, date and address of delivery.....  
 RESTRICTED DELIVERY  
 Show to whom and date delivered.....  
 RESTRICTED DELIVERY.  
 Show to whom, date, and address of delivery \$

(CONSULT POSTMASTER FOR FEES)

2. ARTICLE ADDRESSED TO:  
 Urigh Exploration Inc.  
 Box 2434  
 Midland TX 79702

3. ARTICLE DESCRIPTION:  
 REGISTERED NO. CERTIFIED NO. INSURED NO.  
 P452217054

(Always obtain signature of addressee or agent)

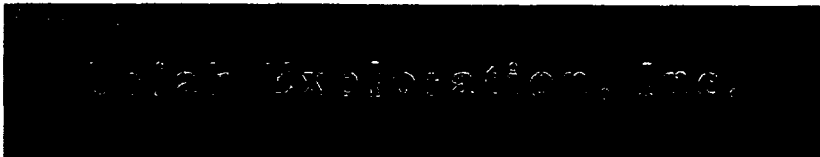
I have received the article described above.  
 SIGNATURE  Addressee  Authorized agent  
 [Signature]  
 DATE OF DELIVERY POSTMARK  
 MIDLAND TX  
 SEP 13 1984  
 UPO

5. ADDRESS (Complete only if requested)

6. UNABLE TO DELIVER BECAUSE: CLERK'S INITIALS  
 [Initials]

★ UPO : 1979-900-459

RETURN RECEIPT, REGISTERED, INSURED AND CERTIFIED MAIL



1/0

GLENN COPE  
PRESIDENT

August 10, 1984

DEAN BOUNDY  
VICE PRESIDENT

*Westall*

*3*

*8377*

Mr. Ray Westall  
P. O. Box 4  
Loco Hills, New Mexico 88255

In Re: Pecos Bend Prospect:  
S/2 of the SE/4  
Section 28; T-23-S  
R-28-E; Eddy County,  
New Mexico

Dear Mr. Westall:

In talking with Bellnorth today, they informed me that you are going to drill on the subject acreage. It is our normal procedure to have a written proposal for our interest in any lease. Since we have not heard from you since our June 14th telephone conversation, we feel we should write you and present our terms on the subject acreage.

We are willing to give you a lease on our interest in the captioned lease for a 50% carried interest through the tanks on our approximately 17% interest in the lease (S/2 of the SE/4 of Section 28).

Please let me know if you wish us to prepare the agreement.

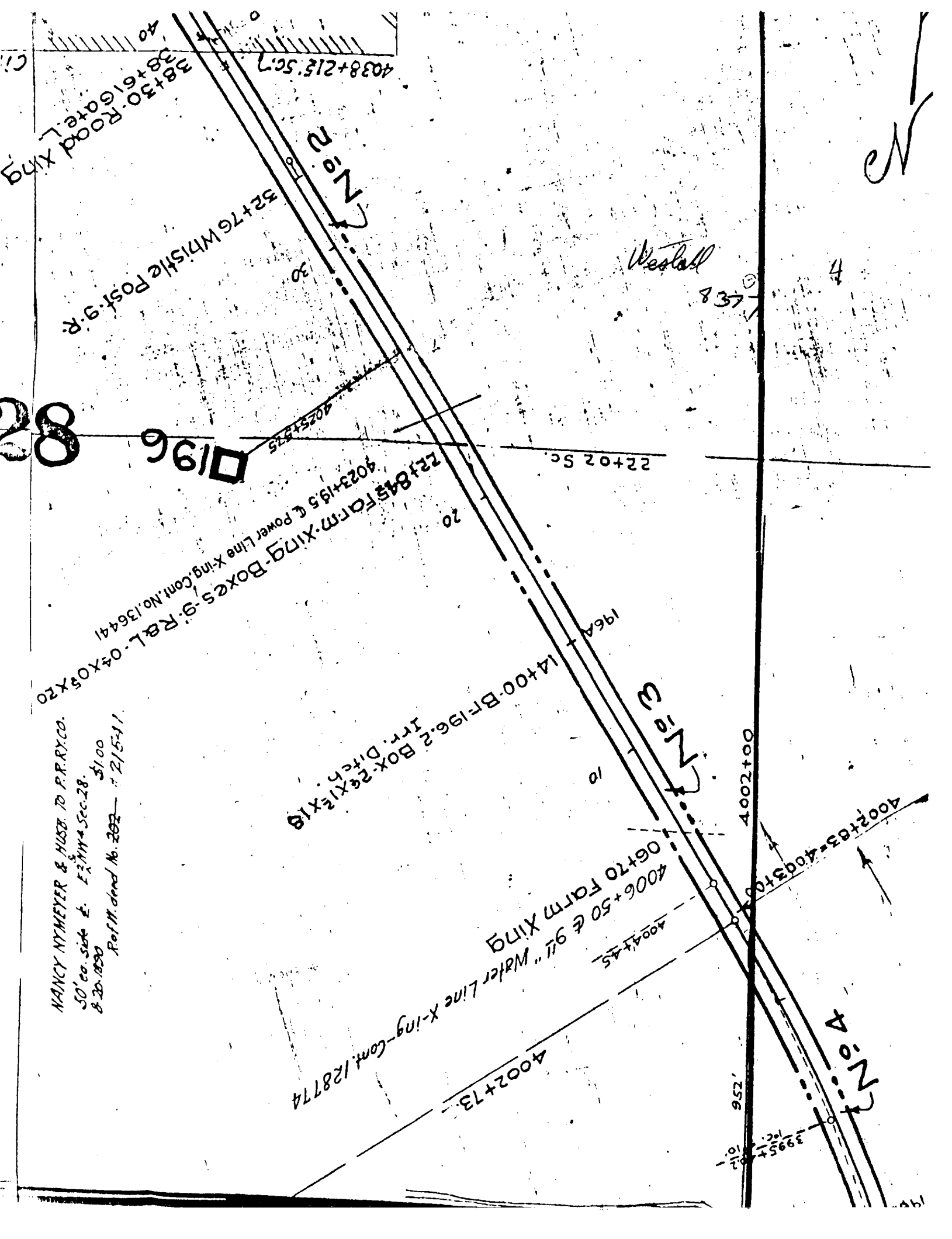
Sincerely,

*Glenn Cope*

Glenn Cope

GC:cc

CERTIFIED/RETURN RECEIPT



88

D/196

Westall

437

NANCY NYMEYER & HUSB. TO P.R.R.Y.CO.  
 50' ea. side E. F2, MW4 Sec. 28. \$1.00  
 8-20-1850 Ref. M. deed No. 202 - 7/15-11

4038+215.5C7  
 38+30-Rood Xing  
 32+76 Whistle Post  
 4023+15.5 C Power Line Xing  
 196A  
 14+00-BF196.2 Box  
 26 X12 X18

4006+50 E 911 Water Line Xing  
 4004+45  
 4002+100  
 4002+100  
 4002+83-4003+00  
 4002+73  
 3995+00  
 952'

Handwritten signature

REVISED 83

September 1, 1984

(Date Prepared)

**AUTHORITY FOR EXPENDITURE**

(WELLS)

Lease Number \_\_\_\_\_ County Wichita Wichita \$ 406,088 411,088  
 (Producer)

Prospect Name & Number CAVALIER PROJECT State New Mexico \$ 196,618 261,318  
 (Dry Hole)

Lease HUCKEROO Well No 1 Field 377 Area of Responsibility \_\_\_\_\_

Location \_\_\_\_\_ Designation \_\_\_\_\_

Description of Work to be Done \_\_\_\_\_ (Circle)  
Bone Springs Test TD 7900' Estimated Date Work to be Commenced \_\_\_\_\_ Completed \_\_\_\_\_

Owner Name \_\_\_\_\_ Interest \_\_\_\_\_ Budget Category \_\_\_\_\_

Opr. Ray Westall Exploration - Drilling & Completion  \_\_\_\_\_  
 Development - Drilling & Completion  \_\_\_\_\_  
 Development - Secondary Development  \_\_\_\_\_  
 (Budget Code)

DETAILS OF ESTIMATED COST	ACCTG. CODE NO.	ESTIMATED COST COST BASED ON 100% W.L.	
		PRODUCER	DRY HOLE
<b>INTANGIBLE DRILLING COST</b>			
Surface damage, surveying	01	\$	\$ 20,000
Building location, roads, dig and fill pits	02		12,000
Drilling: 7900 ft. @ \$ 16.00 per foot	03		126,000
Daywork: 1 Days @ \$ 4500 per day	04		4,500
Pulling and swabbing unit: 7 days @ \$ 1100 per	05	7,700	
Mud, fuel, water	06		10,000
Cementing service, float eqpt., centralizers, scratchers	07	8,000	4,000
Perforating, logging, drill stem testing	08	18,000	
Acid treatment, frac treatment	09	25,000	
Trucking	10	1,000	1,000
Geological and production supervision	11		7,500
Miscellaneous	12	1,000	1,000
Overhead	13		5,000
Roustabout work	14	1,000	
Plugging Expense	19		5,000
<b>Total Intangible Cost</b>			
<b>TANGIBLE COST</b>			
Casing: 8 5/8" 450' 24# 8.04 per foot = 3,618	20	43,371	3,618
5 1/2" 7900' 15.5# 5.49 per foot = 43,371			
Tubing: 2 7/8" J55 2.70 per foot 7900'	21	22,041	
Well head equipment Surface and casing	22	2,500	
Pumping unit, engine, and labor to install 456 CHL 3/4" engine	23	50,000	
Sucker rods and sub-surface pump 7/8" 2500' X1,4225 3/4" 5400' X1,505	24	11,858	
Tank battery 2-300 bbl tk. 4X20 treater 100 bbl str. tk.	25	15,000	
Flow line & connections	26	2,000	
Miscellaneous roustabout crew	27	3,000	
Salt Water Disposal Equipment	28		
Plant Equipment	29		
<b>Total Tangible Cost</b>		153,789	
<b>Total Estimated Cost</b>		411,088	

Remarks This is an estimated cost with gas engine if electricity is available it should be less expensive.

Operator's Approval  
Ray Westall  
 (Recommended by) (Originating Party)  
 \_\_\_\_\_  
 (Approved by)  
 \_\_\_\_\_  
 (Approved by)  
 \_\_\_\_\_  
 (Approved by)

Non Operator's Approval  
 Date \_\_\_\_\_  
 By \_\_\_\_\_  
 Title \_\_\_\_\_  
 For \_\_\_\_\_